Financial Viability in Planning
RICS Guidance Note

April 2012
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Executive Summary

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RICS Guidance Notes

This is a guidance note. It provides advice to members of RICS on aspects of the profession. Where procedures are recommended for specific professional tasks, these are intended to embody ‘best practice’, that is, procedures which in the opinion of RICS meet a high standard of professional competence.

Members are not required to follow the advice and recommendations contained in the guidance note. They should, however, note the following points.

When an allegation of professional negligence is made against a surveyor, the court is likely to take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the surveyor has acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence by virtue of having followed those practices. However, members have the responsibility of deciding when it is appropriate to follow the guidance. If it is followed in an inappropriate case, the member will not be exonerated merely because the recommendations were found in an RICS guidance note.

On the other hand, it does not follow that a member will be adjudged negligent if he or she has not followed the practices recommended in this guidance note. It is for each individual chartered surveyor to decide on the appropriate procedure to follow in any professional task. However, where members depart from the good practice recommended in this guidance note, they should do so only for good reason. In the event of litigation, the court may require them to explain why they decided not to adopt the recommended practice.

In addition, guidance notes are relevant to professional competence in that each surveyor should be up to date and should have informed him or herself of guidance notes within a reasonable time of their promulgation.

This guidance makes reference in a number of places to the RICS Valuation - Professional Standards 2012 (the Red Book) which is effective form 30 March 2012. Although reference is made in this guidance to the Red Book, it is not to be read as Red Book related guidance.
Financial viability has become an increasingly important material consideration in the planning system. Whilst the fundamental purpose of good planning extends well beyond financial viability, the capacity to deliver essential development and associated infrastructure is inextricably linked to the delivery of land and viable development.

The Government’s recent National Planning Policy Framework (NPPF) emphasises deliverability and the provision of competitive returns to willing landowners and developers to enable sustainable development to come forward. This guidance note seeks to elaborate on how this can be achieved.

This guidance note starts from the premise that the private sector will continue to be relied upon to deliver the majority of commercial, residential and mixed-use developments together with consequential planning obligations. It further recognises that development for which there is no plausible business case, on viability grounds or for other reasons, will not take place which is clearly recognised in the NPPF. A shared understanding of development viability for planning purposes by all those involved is therefore essential to achieve consistency in both approach and assessment.

The purpose of this guidance note is to enable all participants in the planning process to have a more objective and transparent basis for understanding and evaluating financial viability in a planning context. Arriving at an outcome which is satisfactory for all should be much easier where there is an agreed framework and basis for evaluation. It is acknowledged that the market is constantly moving, however the principles set out in the guidance should be applicable in all states of the economy and property sector.

Whilst this guidance note provides practitioners with advice in undertaking and assessing viability appraisals for planning purposes, it will also be helpful to users of these assessments, be they planners, developers, investors, landowners, interested parties, individuals or community groups.

Financial viability assessments for planning purposes should be approached on an objective and best practice basis to the extent that the conclusions are capable of unbiased objective scrutiny. This may occur during all stages of the development management process, including to appeal at a public inquiry, or, in the case of policy making, through to an examination in public.

The guidance note sets out a methodology framework and set of principles for financial viability in planning. These have been formulated mainly for development management purposes but they equally apply to plan making and to the viability testing that underpins Community Infrastructure Levy (CIL) charging schedules. So whilst the guidance note has a particular focus on development
management, and therefore the application of viability assessments at a scheme specific level, the principles should apply equally to area-wide viability testing.

We have consulted widely within the industry in producing the guidance note. It is fundamentally grounded in the statutory and regulatory planning regime as it should operate in the UK. We have deliberately avoided reference to planning appeals and case law where viability has been an issue, given the lack of previous guidance in this area for decision makers to refer to and rely upon in formulating their views. It will however be apparent that elements of the guidance closely reflect certain decisions as financial viability in planning has evolved.

The guidance note, for the first time, defines financial viability for planning purposes; separates the key functions of development, being land delivery and viable development (in accordance, and consistent, with the NPPF); highlights the residual appraisal methodology; defines site value for both scheme specific and area-wide testing in a market rather than hypothetical context; what to include in viability assessments; terminology and suggested protocols; and the uses of financial viability assessments in planning. The guidance note is also consistent with, and has regard to, the recently released NPPF.

Importantly the guidance note does not seek to introduce new approaches to such matters as Site Value, for example. Well understood and recognised terminology and definitions are highlighted and clarification provided within the context of the guidance.

The guidance note is divided into various sections to assist both practitioners and users. Sections 1 and 2 and accompanying Appendices A, B C, F and G of this guidance note should assist users of viability assessments, but also contains important guidance for practitioners. Section 3 (and accompanying Appendices D and E) is principally aimed at practitioners. Section 4 is for both users and practitioners in providing further professional advice in the production of viability assessments. An Executive Summary follows which highlights a number of key aspects of the guidance note. Finally, Appendix G, at the end of this guidance note provides a summary of FAQs together with references to various parts of the guidance.

The Working Party wish to highlight that it is not the purpose of this guidance note to tell practitioners how to do a financial viability assessment. This will inevitably vary in each instance. The guidance however provides a framework, methodology and principles which should be applied, without seeking to be prescriptive. The guidance note, for example, does not suggest a particular financial model, ranges of input / benchmark outcomes, etc. It is up to the practitioners to advise accordingly in each case. It is also intended that a “Viability Community” will be established on-line by the RICS to facilitate continued debate in this important area.
It is stressed that this guidance note encourages practitioners at all times to be reasonable and objective in their approach whether undertaking viability assessments or scrutinising them, and where possible to seek to resolve differences of opinion in order to assist the planning process where it is relying on financial viability as a material consideration.

Finally, I would like to thank the consultants to the Working Group of the University of Reading and GVA, my fellow members of the Working Group and all those who contributed and provided comments in producing this guidance note.

Simon Radford

Chair
RICS Working Group
Financial Viability in Planning
Executive Summary

1. The guidance note provides all those involved in financial viability in planning and related matters with a definitive and objective methodology framework and set of principles that can be applied for both plan making and development management.

2. The guidance note is grounded in the statutory and regulatory planning regime that currently operates in the UK. It is consistent with the Localism Act 2011, the National Planning Policy Framework (NPPF) and the Community Infrastructure Levy (CIL) Regulations 2010.

3. The most common uses for financial viability assessments as set out in this guidance note are for development management (including affordable housing, enabling development, land use, Section 106 Agreement planning obligations) and plan making (policy and CIL viability testing). The guidance note has a particular focus on development management (scheme specific assessments) although the principles set out are equally applicable to plan making and CIL (area-wide) viability testing.

4. Financial viability for planning purposes is defined as follows:

   “An objective financial viability test of the ability of a development project to meet its costs including the cost of planning obligations, whilst ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project.”

5. The guidance note separates the two key components of development: land delivery and viable development. This is in accordance with the NPPF. Fundability is also an intrinsic element of both.

6. The residual appraisal methodology for financial viability testing is normally used, where either the level of return or site value can be an input and the consequential output (either a residual site value or return respectively) can be compared to a benchmark in order to assess the impact of planning obligations or policy implications on viability.

7. The guidance note does not recommend any particular financial model (bespoke or otherwise) or provide indications as to inputs or outputs commonly used. It is up to the practitioner in each case to adopt and justify as appropriate.

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1 Where viability is being used to test and inform planning policy it will be necessary to substitute “a development project” and “project” into the wider context.
8. Site Value either as an input into a scheme specific appraisal or as a benchmark is defined in the guidance note as follows:-

"Site Value should equate to the Market Value\(^2\) subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan."

9. When undertaking Local Plan or CIL (area-wide) viability testing, a second assumption needs to be applied to the above:

"Site Value (as defined above) may need to be further adjusted to reflect the emerging policy / CIL charging level. The level of the adjustment assumes that site delivery would not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment."

10. The guidance note encourages practitioners to be reasonable, transparent and fair in objectively undertaking or reviewing financial viability assessments. Where possible, practitioners should seek to resolve differences of opinion.

11. In undertaking scheme specific viability assessments, the nature of the applicant should normally be disregarded as should benefits or dis-benefits that are unique to the applicant. The aim should be to reflect industry benchmarks in both development management and plan making viability testing.

12. Viability assessments will usually be dated when an application is submitted (or when a CIL charging schedule or Local Plan is published in draft). Exceptions to this may be pre-application submissions and appeals. Viability assessments may occasionally need to be updated due to market movements during the planning process.

13. The guidance note highlights where re-appraisals (i.e. viability reviews prior to scheme or phase implementation) or projection (growth) models may be appropriate as an alternative to current day methodologies. It is assumed that for CIL charging schedules and local plan testing this will be undertaken on a current day basis, subject to suitable margins / buffers.

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\(^2\) The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
14. It is strongly recommended that financial appraisals are sensitivity tested, as a minimum, and with more complex schemes, further scenario / simulation analysis should also be undertaken. This is to ensure that a sound judgement can be formulated on viability.

15. The guidance note sets out what should usually be included in viability assessments, common terminology and definitions, together with additional technical guidance for practitioners.

16. Confidentiality protocols and suggested non-binding mediation / arbitration mechanisms for resolving disputes are set out in the guidance note.
1 Introduction

Key Issues: purpose of the guidance note; viability context in national and local planning policy; use of viability appraisals in planning; and an effective framework for viability testing.

1.1 The motivation for undertaking this guidance note arose from the gap (partly as a result of a lack of clear published guidance) which often occurs between what many local planning authorities consider may be viable to provide, and what development proposals are actually capable of supporting financially, in terms of planning obligations, whilst seeking to meet policy requirements. This does not just relate to the ‘development management’ stage of the planning process where section 106 agreements are negotiated, but is also evident at the beginning of the spatial planning process where policy is formulated in local development plan documents. Viability testing is also relevant to local planning authorities when drafting Community Infrastructure Levy (CIL) charging schedules.

1.2 More specifically the guidance aims to satisfy the following requirements:

- outline the statutory/regulatory/policy background in considering viability assessments in a town planning context;
- clearly define terminology in a way that is consistent with existing RICS usage;
- clearly define financial viability in the context of planning and development;
- enable an objective evaluation of financial viability to be made;
- set down the parameters within which issues of financial viability are to be considered;
- establish the principles upon which these will be evaluated;
- be applicable at all stages in the economic cycle; and
- be applicable to all scales of site whether greenfield or urban.

3 An advice note on how to conduct Plan level viability work is being prepared by the HCA Local Housing Delivery Group.
1.3 The intention of this guidance note is to provide local planning authorities, developers, investors, land owners, interested parties, individuals or community groups and all professionals including chartered surveyors with definitive and impartial objective guidance on viability in a development management and plan making context. In respect of the former, this includes evaluating the impact of planning obligations, including affordable housing and other section 106 requirements, CIL (including the application of tariffs/levies), and planning policy on the financial viability of a proposed development. So far as the latter is concerned, whilst the focus of this guidance is on the development management stage dealing with site specific applications, the principles can be applied equally to area wide viability in respect of Local Plans and CIL Charging schedules.

Box 1:

The guidance note provides all those involved in financial viability in planning and related matters with a definitive and objective methodology framework and set of principles that can be applied for both plan making and development management.

Viability in National Planning Policy Context

1.4 Whilst always central in the development process, viability has become an increasingly important consideration in town planning. Whether preparing policy or considering a specific proposal scheme viability is inherently linked to the ability to satisfy planning policy, and to deliver regeneration objectives and economic development. The significance of viability has increased during periods of economic downturn when the delivery of new development has been threatened and the relative burden on developers and landowners of planning obligations and policy requirements has increased. Striking the right balance to deliver development in the right place at the right time is therefore essential.

1.5 In undertaking development the private sector is often called upon by local planning authorities (LPAs) to deliver and / or contribute towards the provision of infrastructure and mitigate potential harm arising from a proposed development. Scheme viability is a material consideration in deciding the appropriate level of contribution. It is important therefore for LPAs to have a greater understanding of viability as it is relevant to planning in both the formulation of planning policy, as well as in the determination of
planning applications. In the former, the emphasis is upon deliverability of an authority’s vision / infrastructure or community requirements, during the plan period. The latter relates to an authority’s willingness to consider a scheme to proceed after relaxation of policy and/or planning obligations in the context of poor viability. A full assessment of the implications for planning is provided in Appendix A and a summary is provided below.

1.6 Reference is made throughout this guidance note to national planning guidance set out in the National Planning Policy Framework (NPPF)\(^4\) and the Community Infrastructure Levy Regulations and other relevant national policy.

**National Planning Policy Framework**

1.7 In the context of achieving sustainable development the National Planning Policy Framework refers to ensuring viability and deliverability at sections 173 – 177.

‘... To ensure viability, the costs of any requirements likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking into account of the normal cost of development and mitigation, provide competitive returns to a willing land owner and willing developer to enable the development to be deliverable’

(Para. 173, National Planning Policy Framework)

**Community Infrastructure Levy Regulations**

1.8 Since April 2010 the tests for determining the lawfulness of planning obligations are set out in regulation 122 of the Community Infrastructure Levy Regulations 2010. The 2010 Regulations provide that a planning obligation may only constitute a reason for granting planning permission if it is: (a) necessary to make the development acceptable in planning terms; (b) directly related to the development; and (c) fairly and reasonably related in scale and kind to the development. These three prerequisites are the same as three of the five policy tests for planning obligations in Annex B to Circular 05/2005.

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\(^4\) National Planning Policy Framework published 27 March 2012
Box 2:

The guidance note is grounded in the statutory and regulatory planning regime that currently operates in the UK. It is consistent with the Localism Act 2011, National Planning Policy Framework of 2012 and Community Infrastructure Levy (CIL) Regulations 2010.

1.9 Further background information on both the above document and other relevant planning considerations upon which this guidance note have been based is set out in Appendix A.

The Use of Viability Appraisals in Planning

1.10 Viability appraisals may be used in connection with a number of planning related issues in respect of both policy assessment and development control. For the latter, it is usual to apply a “reasonableness” test. This may take the form, for example, of “the maximum reasonable amount of affordable housing in terms of the economic viability of a development”. Reasonableness should be considered of utmost importance in all instances where viability appraisals are undertaken. In certain instances financial viability may be relevant in the context of seeking to depart from planning policy. The most common uses of viability appraisals include:

- assessing the nature and level of planning obligation contributions/requirements;
- establishing the level of affordable housing;
- identifying the split between affordable housing tenures;
- establishing off-site affordable housing levels including the quantification of overprovision and affordable housing credits;
- assessing contributions in lieu of payments for affordable housing;
- the timing of planning obligations contributions and affordable housing delivery;
- applications incorporating enabling development;
- assessing the bulk, scale and massing (and specification relative to cost and value) of a proposed scheme;

- reviewing land uses;

- assessing continuing existing uses in terms of obsolescence and depreciation;

- dealing with heritage assets and conservation issues;

- formulating planning policy through local development plans; and

- as a relevant consideration to local authorities when drafting and viability testing CIL (Community Infrastructure Levy) charging schedules.

**Box 3:**

The most common uses for financial viability assessments are set out in the guidance note for development management (including affordable housing, enabling development, land use, Section 106 Agreement planning obligations) and plan making (policy and CIL viability testing). The guidance note has a particular focus on development management (scheme specific assessments) although the principles set out are equally applicable to plan making and CIL (aera-wide) viability testing.

1.11 In many instances a viability assessment will have regard to not just single policy impacts but a cumulative impact of policy and planning obligations as illustrated in Figure 1.
1.12 This guidance note is therefore intended to provide an effective framework within which financial viability may be assessed, having regard to the regulatory regime in place and at whatever the stage of the economic cycle in which the evaluation is being carried out (Appendix B provides a property market context overview). It seeks to provide a rigorous approach to evaluating financial viability and reaching an appropriate professional judgement in the context of assessing the introduction of planning obligations, formulating planning policy and establishing CIL charging schedules.
2 Key Features of a Development Viability Assessment

Key Issues: definition of viability for planning purposes; an appraisal framework; definition of Site Value for scheme specific appraisals and area wide studies; using a viability assessment to arrive at a professional judgement; and indicative outline of what to include in a viability assessment.

Definition of Viability for Planning Purposes

2.1 The guidance provides this definition in the context of undertaking appraisals of financial viability for the purposes of town planning decisions:

“An objective financial viability test of the ability of a development project to meet its costs including the cost of planning obligations, whilst ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project.”

2.2 The fundamental issue, in considering viability assessments in a town planning context is whether an otherwise viable development is made unviable by the extent of planning obligations or other requirements. This is illustrated in Figure 2 in terms of comparative development viability.

5 Where viability is being used to test and inform planning policies, it will be necessary to substitute “development project” and “project” in to the wider context.
Figure 2: Comparative Development Viability

Box 4:

Financial viability for planning purposes is defined as follows:

"An objective financial viability test of the ability of a development project to meet its costs including the cost of planning obligations, whilst ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project."  

2.3 A proper understanding of financial viability is essential to ensure that:

(i) land is willingly released for development by landowners;

(ii) developers are capable of obtaining an appropriate market risk adjusted return for delivering the proposed development;

Where viability is being used to test and inform planning policy it will be necessary to substitute “a development project” and “project” into the wider context.
(iii) the proposed development is capable of securing funding;

(iv) assumptions about the quantum of development that can be viably delivered over the course of the plan period are robust; and

(v) CIL charging schedules are set at an appropriate level / degree of flexibility.

2.4 Where planning obligation liabilities reduce the site value to the landowner and return to the developer below an appropriate level, land will not be released and/or development will not take place. This is recognised in the NPPF (see paragraph 1.7 above and Appendix A).

Box 5:
The guidance note separates out the two key components of development: land delivery and viable development. This is consistent with the NPPF.

Appraisal Framework

2.5 An objective test of financial viability for projects should be placed in the context of a well-established set of appraisal techniques and their applications. An accepted method of valuation of development schemes and land is set out in RICS Valuation Information Paper (VIP) 12. This approach, called the residual method, recognises that the value of a development scheme is a function of a number of elements: the value of the completed development (gross development value (GDV)), the direct costs of developing the property (gross development cost (GDC)), the return to the developer for taking the development risk and delivering the scheme, the cost of any planning obligations and the cost or value of the site. The residual approach is used for development situations where the direct comparison with other transactions is not possible due to the individuality of development projects. However practitioners will seek to check residual development appraisals with market evidence.

2.6 The residual appraisal method can be used in two basic ways: first, to assess the level of return generated from the proposed project where site cost is an input into the appraisal; and, secondly, to establish a residual site value by inputting a predetermined level of return.
2.7 In summary, the financial viability test can use the level of developer’s return or the residual site value as the benchmark for assessing the impact of planning obligations on viability.\(^7\)

**Box 6:**

The residual appraisal methodology for financial viability testing is normally used, where either the level of return or Site Value can be an input and the consequential output (either a residual site value or return respectively) can be compared to a benchmark in order to assess the impact of planning obligations or policy implications on viability.

**Definition of Site Value**

2.8 Site Value either as an input into a scheme specific appraisal or as a benchmark is defined as follows:-

“Site Value should equate to the Market Value\(^8\) subject to the following assumption; that the value has regard to development plan polices and all other material planning considerations and disregards that which is contrary to the development plan.”

2.9 Any assessment of Site Value, will therefore have regard to prospective planning obligations and the point of the viability appraisal is to assess the extent of these obligations whilst also having regard to the prevailing property market. This point is discussed further in Section 3.

\(^7\) Whilst the majority of financial viability assessments use the residual approach, there may be certain circumstances where other appraisal methodologies are appropriate and should be used by the practitioner.

\(^8\) The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
Box 7:

Site Value either as an input into a scheme specific appraisal or as a benchmark is defined in the guidance note as follows:-

“Site Value should equate to the Market Value subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan.”

2.10 When undertaking Local Plan or CIL (area-wide) viability testing, a second assumption needs to be applied to the definition of Site Value above:-

“Site Value (as defined above) may need to be further adjusted to reflect the emerging policy/CIL charging level. The level of the adjustment assumes that site delivery would not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment.”

Box 8:

When undertaking Local Plan or CIL (area-wide) viability testing, a second assumption needs to be applied to the above:

“Site Value (as defined above) may need to be further adjusted to reflect the emerging policy / CIL charging level. The level of the adjustment assumes that site delivery would not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment.”

*As above
2.11 Valuation and formulating appropriate judgements is an intrinsic part of appraisals that contain a significant number of variables. These variables may change over time and will reflect the movement in the property market generally (see Appendix B). The appraisal date must therefore be clearly stated and inevitable uncertainty addressed through sensitivity or similar analysis. It is for the practitioner to decide in each specific case if the advice being provided falls within the ambit of the RICS Valuation Standards or its exceptions.

2.12 The residual approach can be applied with differing levels of information and sophistication and it is for the practitioner to decide upon the most appropriate application of any financial model, bespoke or otherwise.

2.13 The basic residual valuation concept is straightforward, but difficulties can arise not only in the method itself, but also in estimating the values of the many variables that go into the appraisal. The residual answer can also be sensitive to small changes in some variables. It is appropriate and strongly recommended, therefore, for some form of sensitivity (scenario and/or simulation) analysis to be undertaken. This would examine the effect of changes in the level of individual variables on the residual site value (or developer’s return) to test the key assumptions in order to ensure that they are soundly based, before a judgement is finalised and the residual land value (or return required) is finally determined and a full picture of development viability ascertained.

Box 9:

It is strongly recommended that financial appraisals are sensitivity tested, as a minimum, and with more complex schemes, further scenario / simulation analysis should also be undertaken. This is to ensure that a sound judgement can be formulated on viability.

2.14 It is also recommended that additional checks are undertaken on the estimated residual site value (when this is the purpose of the calculation). These checks would include comparison with the sale price of land for similar development, where such evidence exists, based on site value per hectare or per unit of development (particularly for
greenfield development) and calculation of the ratio of the residual site value to the capital value of the scheme and how this ratio compares to other evidence of similar transactions.

2.15 The value of development land (Site Value) has regard to what can be developed on that land and the value and cost and timing of that development. Furthermore, the value of that development is not directly related to its cost, but is created by the interplay of market forces. These market forces include the supply of, and demand for, development properties and land in the market. This in turn is influenced by the planning system, the availability of funding through the financial system, residential and occupier demand, and the property investment and capital markets.

2.16 Where the residual appraisal method has assessed the level of return, it will be necessary to form a professional judgement as to that return’s acceptability in respect of the proposed development. This will have regard to both market forces as described above and the intrinsic risks associated with the scheme being appraised. An acceptable return may fall within a prescribed range or may be required to seek to achieve a minimum target level for a proposed development. The judgement formulated will in practice need to be justified having regard to paragraphs 2.13 and 2.14.

**Indicative Outline of what to Include in a Viability Assessment**

2.17 As an illustration of what a viability assessment should comprise of, Appendix C provides a checklist. It should be noted that the level and detail of information forming the viability assessment will vary considerably from scheme to scheme (and in the case of plan making and CIL charging schedules). It is up to the practitioner to submit what they believe is reasonable and appropriate in the particular circumstances and for the local authority or their advisers to agree whether this is sufficient for them to undertake an objective review.

2.18 When determining planning applications, LPAs are concerned with the merits of the particular scheme in question. They should disregard who is the applicant (except in exceptional circumstances such as personal planning permissions) as planning permissions run with the land. It follows that in formulating information and inputs into viability appraisals, these should disregard either benefits or disbenefits that are unique to the applicant (whether landowner, developer or both), for example internal financing arrangements. The aim should be to reflect industry benchmarks as applied to the
particular site in question for a planning application or as appropriate for the wider area in the context of the preparation of policy or the setting of the CIL charging schedules. Clearly, there must be consistency in viability principles and application across these interrelated planning matters.

Box 10:

In undertaking scheme specific viability assessments, the nature of the applicant should normally be disregarded as should benefits or dis-benefits that are unique to the applicant. The aim should be to reflect industry benchmarks in both development management and plan making viability testing.

2.19 The guidance note does not recommend any particular financial model (bespoke or otherwise) or provide indications as to inputs or outputs commonly used. It is up to the practitioner in each case to adopt and justify as appropriate.

Summary

2.20 This section has outlined the basic approach to assessing development viability that is commonly used in practice. Appendix D contains refinements to the basic residual method of assessing development viability, including cash flows and DCF analysis (internal rate of return (IRR) and net present value (NPV) approaches) and the effects of inflation and forecasting are set out. Section 3 provides a detailed consideration of development viability and site value benchmarks to determine whether the scheme (or planning policy) is viable or not, and therefore the level of planning obligations that can be afforded or compliance with policy met.

2.21 Appendix E, sections 2 and 3, provide details of the types of developer and the constituent parts of the development appraisal model.
3 Viability and Site Value Benchmarks

**Key Issues:** principles that practitioners should take into account; model and approach; developer’s return approach; Site Value approach; date of assessment; actual purchase price; holding costs; third party interests; vacant possession and relocation costs; reappraisals; and projection models.

3.1 This section is intended to provide a more detailed consideration of financial viability assessments for the purposes of the practitioner. It provides an approach to assessing viability, rather than specifying a prescriptive tool or financial model. It therefore does not remove the need for developers, local planning authorities and other interested parties to seek advice from appropriately qualified professionals when undertaking or reviewing viability assessments.

3.2 This guidance follows the usual approach of setting down a set of principles that practitioners should take into account. It does not give specific examples but leaves this discretion to the professionals in providing suitably appropriate advice.

3.3 As part of providing a viability framework it is necessary to set out clear guidance on the assessment of land values to be used in viability assessments. Much of this section is focused on scheme specific development management but the principles are equally applicable to area-wide viability testing. Appendix D sets out further refinements to viability methodology having regard to cashflowing, inflation in costs and values and more complex developments.

**Model and Approach**

3.4 In assessing the impact of planning obligations on the viability of the development process, it is accepted practice that a residual valuation model is most often used. This approach uses various inputs to establish a GDV from which GDC is deducted. GDC can include a Site Value as a fixed figure resulting in the developer’s residual profit (return) becoming the output which is then considered against a benchmark to assess viability. Alternatively the developer’s return (profit) is an adopted input to GDC leaving a residual land value as the output from which to benchmark viability, i.e. being greater or less than what would be considered an acceptable Site Value.
3.5 When a developer’s return is the output, a scheme should be considered viable as long as the cost implications of planning obligations are not set at a level at which the developer’s return (after allowing for all development costs including site value) falls below that which is acceptable in the market for the risk in undertaking the development scheme. If the cost implications of the obligations erode a developer’s return below an acceptable market level for the scheme being assessed, the extent of those obligations will be deemed to make a development unviable as the developer would not proceed on that basis.

3.6 The benchmark return, which is reflected in a developer’s profit allowance, should be at a level reflective of the market at the time of the assessment being undertaken. It will include the risks attached to the specific scheme. This will include both property-specific risk, i.e. the direct development risks within the scheme being considered, and also broader market risk issues such as the strength of the economy and occupational demand, the level of rents and capital values, the level of interest rates and availability of finance. The level of profit required will vary from scheme to scheme, given different risk profiles as well as the stage in the economic cycle. For example, a small scheme constructed over a shorter timeframe may be considered relatively less risky and therefore attract a lower profit margin than a large redevelopment spanning a number of years where the outturn is considerably more uncertain. A development project will only be considered economically viable if the estimated developer’s return meets or exceeds a benchmark risk-adjusted market return.

3.7 When considering what Site Value to include, the relevant value should also be in accordance with the definition of viability for planning purposes (see paragraph 2.1), and is defined as follows:-

**Developer’s Return Approach (where site value is a cost of development)**
“Site Value should equate to the Market Value\textsuperscript{10} subject to the following assumption; that the value has regard to development plan polices and all other material planning considerations and disregards that which is contrary to the development plan.”

3.8 In arriving at a Site Value based on the above definition, this will therefore have regard to prospective planning obligations. The purpose of the viability appraisal is, of course, to assess the extent of these obligations whilst also having regard to the prevailing property market. This point is discussed further in paragraphs 3.15 and 3.16.

3.9 When undertaking Local Plan or CIL (area-wide) viability testing, a second assumption needs to be applied to the definition of Site Value above:-

“Site Value (as defined above) may need to be further adjusted to reflect the emerging policy/CIL charging level. The level of the adjustment assumes that site delivery would not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment.”

3.10 The amendment to Market Value for CIL or Local Plan viability testing has not yet happened in the market, i.e. the effect on the Market Value of land of the new policy (or changes to existing) or the burden of CIL charge. There is of course a spectrum ranging from CIL testing where there is no planning policy change through to a whole-scale policy change within the local Plan. It follows that if the latter end of the spectrum is being tested, the first assumption in the definition of Site Value would fall away, whereas with the former, it would be necessary to retain this assumption. There must, however, be a “boundary” placed on the effect on land, to reflect new policy or the burden of CIL charge, in terms of restricting any reduction so that it does not go below what land would willingly transact at in order to provide competitive returns to a willing landowner\textsuperscript{11}. The above definition is therefore not prescriptive and leaves the practitioner to make an appropriate judgement which must be reasonable, having regard to the workings of the

\textsuperscript{10} The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

\textsuperscript{11} National Planning Policy Framework (paragraph 173)
property market. Clearly, if sites are not willingly delivered at competitive returns to the market, development will not take place, i.e. it will not be deliverable.

Box 11:

Site value either as an input into a scheme specific appraisal or as a benchmark is defined in the guidance note as follows:-

“Site value should equate to the Market Value\(^{12}\) subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan.”

Box 12:

When undertaking Local Plan or CIL (area-wide) viability testing, a second assumption needs to be applied to the above:

“When Site Value (as defined above) may need to be further adjusted to reflect the emerging policy / CIL charging level. The level of the adjustment assumes that site delivery would not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment.”

Site Value Approach (including an allowance for developer’s return as a cost of development)

3.11 To date, in the absence of any guidance, a variety of practices have evolved which are used by practitioners to benchmark land value. An approach has been to adopt Current Use Value (CUV) plus a fixed percentage or a particular margin or variant of this (i.e. Existing Use Value (EUV) plus a premium). The problem with this approach is that it does not reflect the market as land is not released at CUV or CUV plus a margin (EUV plus). The margin mark-up is also arbitrary and inconsistently applied in practical application as a result. This could either undervalue or overvalue land as an input Site Value (or as a benchmark) as indicated in the diagram below which illustrates EUV plus

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\(^{12}\) The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
compared to Market Value with an assumption, and the resultant impact on planning obligations that can be viably afforded. Appendix E sets out further detail on why a CUV approach is incorrect.

Figure 3:

Market Value (with assumption) v. Existing Use (plus)

3.12 In a market without planning obligations, the maximum value of a development opportunity would be the residual value of the site with the proposed planning permission after development profit and all development expenses have been deducted from the GDV of the proposed scheme. In this situation, if this value was above the current use value (defined in Appendix F, Glossary of terms) of the site, landowners are more likely to deliver a site for development. The level of uplift arising which would result in land being released for development could vary considerably between individual sites.

3.13 The residual site value (ignoring any planning obligations and assuming planning permission is in place) and current use value represent the parameters within which to assess the level of any planning obligations. Any planning obligations imposed will need to be paid out of this uplift but cannot be the whole of this difference, other than in exceptional circumstances, as that would remove the likelihood of the land being released for development.
3.14 For a development to be financially viable, any uplift from current use value to residual land value that arises when planning permission is granted must be able to meet the cost of planning obligations whilst ensuring an appropriate site value for the landowner and a market risk adjusted return to the developer in delivering that project (the NPPF refers to this as “competitive returns” respectively). The return to the landowner will be in the form of a land value in excess of current use value but it would be inappropriate to assume an uplift based on set percentages as detailed above and in Appendix E, given the heterogeneity of individual development sites. The land value will be based on market value which will be risk-adjusted, so it will normally be less than current market prices for development land for which planning permission has been secured and planning obligation requirements are known.

3.15 The assessment of market value in these circumstances is not straightforward, but it must be by definition, at a level which makes a landowner willing to sell which is recognised by the NPPF.

3.16 Sale prices of comparable development sites may provide an indication of the land value that a landowner might expect but it is important to note that, depending on the planning status of the land, the market price will include risk-adjusted expectations of the nature of the permission and associated planning obligations. If these market prices are used in the negotiation of planning obligations, then account should be taken of any expectation of planning obligations that is embedded in the market price (or valuation in the absence of a price). In many cases, relevant and up to date comparable evidence may not be available or the heterogeneity of development sites requires an approach not based on direct comparison. The importance, however, of comparable evidence cannot be over-emphasised, even if the supporting evidence is very limited, as evidenced in Court and Land Tribunal decisions.

3.17 This guidance has sought to reflect more appropriately the workings of the market. With a definition of viability established it has been considered appropriate to look at terms the industry is familiar with, rather than invent new ones. Accordingly, the guidance adopts the well understood definition of Market Value as the appropriate basis to assess Site Value, subject to assumption(s) as set out above.

3.18 It has become very common for practitioners to look at Alternative Use Value (AUV) as a land value benchmark. This will come with its own set of planning obligations and
requirements.

3.19 Reviewing alternative uses (see Appendix E) is very much part of the process of assessing the Market Value of land and it is not unusual to consider a range of scenarios for certain properties. Where an alternative use can be readily identified as generating a higher value, the value for this alternative use would be the Market Value. Again, comparable evidence may provide information to assist in arriving at an AUV. The points raised in 3.16 above would again apply. Accordingly, in assessing the Market Value of the land there may well be a range of possible Market Values for different uses which could be applicable to the land and buildings, from current use through to a number of alternative use options, each having its own planning obligation requirements. These will be used to derive the Market Value with assumption (being the highest) for the Site Value input into a viability assessment.

Box 13:

The assessment of Market Value with assumption is not straightforward but must, by definition, be at a level which makes a landowner willing to sell, as recognised by the NPPF. Appropriate comparable evidence, even where this is limited, is important in establishing Site Value for scheme specific as well as area wide assessments.

Date of Assessment

3.20 The date upon which the planning authority resolves to grant or refuse a planning application (or the Secretary of State – see below) is the date upon which all relevant information is considered. In practical terms, reports and supporting documentation are prepared well in advance of this date. It follows that the ‘appraisal date’ should be carefully considered and agreed. If the viability assessment is provided pre-application, then the date of the assessment will clearly be prior to the submission of an application. The viability assessment may subsequently require updating when the application is submitted. If the viability assessment is submitted with a planning application, the date of the application (not the date of registration) may be the appropriate date but it is important to note that the decision of the LPA on a planning application must be based on the material considerations at the date of determination, hence the conclusions of a viability assessment undertaken at the date of application must still hold good at the date of decision. Viability assessments may therefore occasionally need to be updated
to market movements during the planning process.

3.21 There are occasions where the appraisals will require revisions. In certain circumstances, as a result of say fundamental market changes (or, for example, changes in density of the scheme), between submission of the viability assessment, application and consideration by the planning authority, it will be necessary to review and update the appraisal. This should, however, relate to changes in the market (or changes specific to the scheme) that would not have been known at the time of the original submission. Where there is a planning appeal, the date should be agreed between the parties or taken as the date of the hearing/written representations.

Box 14:

Viability assessments will usually be dated when an application is submitted (or when a CIL charging schedule or Local Plan is published in draft). Exceptions to this may be pre-application submissions and appeals. Viability assessments may occasionally need to be updated due to market movements or if schemes are amended during the planning process.

Other Material Issues

Actual purchase price

3.22 Site purchase price may or may not be material in arriving at a Site Value for the assessment of financial viability. In some circumstances the use of actual purchase price should be treated as a special case. Issues to consider are:

- a viability appraisal is taken at a point in time taking account of costs and values at that date. A site may be purchased some time before a viability assessment takes place and circumstances might change. This is part of the developer’s risk. Site values can go up or down between the date of purchase and a viability assessment taking place; in a rising market developers benefit, in a falling market they may lose out;

- a developer may make unreasonable/over optimistic assumptions regarding the type and density of development or the extent of planning obligations, which means that it has overpaid for the site;
• where plots have been acquired to form the site of the proposed development, without the benefit of a compulsory purchase order, this should be reflected either in the level of site value incorporated in the appraisal or in the development return. In some instances site assembly may result in synergistic value arising (see also Appendices E and F); and

• the Market Value of the site should always be reviewed at the date of assessment in any event and compared with the purchase price and associated holding costs and the specific circumstances in each case.

3.23 It is for the practitioner to consider the relevance or otherwise of the actual purchase price, and whether any weight should be attached to it, having regard to the date of assessment and the Site Value definition as set out in this guidance.

Box 15:

It is for the practitioner to consider the relevance or otherwise of the actual purchase price, and whether any weight should be attached to it, having regard to the date of assessment and the Site Value definition as set out in this guidance. Where historic costs are stated it is important it is important that these are not reflected in the Site Value (i.e. double counted).

Holding costs

3.24 The site will be valued at the date of assessment. Holding costs attributable to the purchase of the site should not normally therefore be allowed as the site value will be updated. In phased schemes where land is valued at the beginning of the development and land is drawn down for each phase, it may be appropriate to apply holding costs. Also where plots of land have been assembled and subject to assessment it may also be appropriate to include related holding costs. Where holding costs are applicable they should be offset by any income received from the property.

3.25 Other relevant costs subsequent to purchase, including professional fees and other costs incurred in bringing the application forward and holding the site including remediation measures, should be reflected in the development appraisal as appropriate and reasonable.
Third Party Interests, Vacant Possession and Relocation Costs

3.26 Often in the case of development and site assembly, various interests need to be acquired or negotiated in order to be able to implement a project. These may include: buying in leases of existing occupiers or paying compensation; negotiating rights of light claims and payments; part wall agreements, over sailing rights, ransom strips/rights, agreeing arrangements with utility companies; temporary / facilitating works, etc. (see Appendix F in respect of terminology). These are all relevant development costs that should be taken into account in viability assessments. For example it is appropriate to include rights of light payments as it is a real cost to the developer in terms of compensation for loss of rights of light to neighbouring properties. This is often not reflected in Site Value given the different views on how a site can be developed.

Re-appraisals (Viability Reviews)

3.27 The re-appraisal approach, which may be more applicable to certain schemes, allows for planning applications to be determined but leaving, for example, the level of affordable housing to be fixed prior to implementation of the scheme. Such re-appraisals are generally suited to phased schemes over the longer term rather than a single phase scheme to be implemented immediately, which requires certainty. Where long life planning permissions are granted (5 years plus) reappraisals may also be appropriate). As such re-appraisal mechanisms should only be considered the exceptional cases. These appraisals would usually be undertaken during or prior to the reserved matters application stage. Careful consideration would need to be given as to how this is set out in a section 106 agreement, although it will be important to the LPA and applicant to express a range for the assessment (i.e. for the applicant to state the level of obligation above which they would not be expected to exceed and for the LPA to state the level of obligation below which the development will be unacceptable regardless of the benefits that arise from it). The methodology may include, for example setting out: the process involved; the basis of model; inputs; basis of return; and site value. It is stressed that the re-appraisal should always be undertaken prior to the implementation of a scheme or phase in order to fully account at the time for the risk the developer is undertaking, and therefore the appropriate return. So-called “overage” arrangements (post development appraisals) are not considered appropriate, as development risk at the time of implementation cannot be accounted in respect of the inevitable uncertainty of undertaking a development or individual phase.
3.28 It is important to ensure that the drafting of re-appraisal provisions do not result in the earlier phases becoming uncertain as to the quantum of development to be provided on site. This would have the unfortunate effect of stifling development. Each phase requires sufficient certainty to be able to provide the required returns and secure development funding.

**Box 16:**

Re-appraisals may be appropriate for longer term / multi phased schemes and should be undertaken prior to the implementation of a scheme or phase.

**Validity of Projection Models – to capture future market growth**

3.29 An alternative approach to the re-appraisal approach (and current day appraisals) is the use of projection models. In more volatile market conditions, many planning applications may not be viable for the schemes being proposed using present-day values and costs. This reflects a variety of factors that would include the relationship of likely end values to the costs of building the scheme. Inevitably, when such schemes go forward for discussion with the local planning authority, applicants may look at growth models (see Appendix B) and the likelihood of the proposed development becoming viable over the short to medium term with the acceptance that it may not be currently viable. This is normally more relevant to large schemes to be built over the medium to longer term, than for short term projects.

3.30 Current day methodologies for large schemes of a medium to longer term build out duration at times may give the LPA cause for concern as the case is made that the site is not currently viable. As a result they may not achieve the desired outturn in terms of planning obligations, etc. The principle and application of projection models is for sites that are non-viable today but where the likelihood is that development would occur at some future date in the life of a planning permission, or where the development is likely to be over a sufficiently long period of time during which the market conditions may vary.

3.31 It is important to distinguish in such cases between market value growth and site regenerative growth when preparing appraisals of large sites. Larger schemes may be subject to intrinsic/ internal value growth (as a result of development) achieving a critical
mass that may/may not be reflected in the broader market.

3.32 Projection models are valid in terms of assessing the viability of the site. Advisers for both applicant and local authority should put themselves in the position of looking at the potential of the site in the future and assess the likely obligations and commitments that that site can make based on those forecasts, rather than on current-day assessments. Such an approach might enable the LPA to achieve a number of its objectives by adopting the ‘looking forward’ approach, and for both the LPA and applicant to achieve certainty over the level of planning obligations attached to the planning permission. Appendix B provides further information on the effects of inflation and forecasting.

Box 17:

Projection (growth) models are an alternative to current day and reappraisal approaches for assessing the viability of a site. A “looking forward” approach for the LPA and applicant can provide certainty in terms of defining planning obligations for both at the time of granting a planning permission.
4 Further Professional Advice

**Key Issues:** planning and viability; viability appraisals and evidence; preparing and scrutinising a viability assessment; confidentiality; and mediation and arbitration

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**Planning and Viability**

4.1 Whilst this Guidance Note acknowledges the current reform of the planning process in England, the consideration of financial viability will remain an essential element in the determination of planning applications, in the application of planning policy and the negotiation of section 106 agreements. Some planning applications are accompanied by a full financial justification assessment demonstrating, for example, the level of affordable housing that may be viable and this is linked to the balance of other requirements of the scheme.

4.2 A certain degree of knowledge and understanding is therefore needed by planners and decision-makers as to the viability implications of all of the requirements placed on development, and independent expert viability input is usually advisable. Certain section 106 contributions and obligations and other requirements may also be necessary to mitigate the impact of development (sometimes referred to as essential planning mitigation which, if not undertaken, would result in a refusal of planning permission notwithstanding financial viability considerations). Decision-makers, however, should balance these against ensuring development is deliverable having regard to scheme viability.

**Viability Appraisals and Evidence**

4.3 It is important that viability assessments be supported by adequate comparable evidence. For this reason it is important that the appraisal is undertaken by a suitably qualified practitioner who has experience of the type, scale and complexity of the development being reviewed or in connection with appraisals supporting the formulation of core strategies in local development frameworks. This ensures that appropriate assumptions are adopted and judgment formulated in respect of inputs such as values, yields, rents, sales periods, costs, profit levels and finance rates to be assumed in the appraisal. This should be carried out by an independent practitioner and ideally a
suitably qualified surveyor.

4.4 It is common practice for the practitioner to rely upon and form opinions in respect of various components of a viability assessment. For example, it may be appropriate that build cost information is prepared by a quantity surveyor (QS). This may be essential for non-standard developments and complex schemes where to adopt build costs quoted by the Building Cost Information Service (BCIS) may lack the level of detail and robustness required. In general, a QS input will be necessary in many instances, to ensure that the cost element of the appraisal is viewed as fully independent.

4.5 Similarly, planning advice in respect of section 106 (Town and Country Planning Act 1990) assumptions and obligations may need specialist advice. For example, the changing nature of affordable housing may require expertise in terms of tenure split, unit size, grant availability and general pricing. This can be achieved by seeking a bid from a registered provider or by appointing a practitioner with expertise in this area as assumptions vary on a case-by-case basis. Reference should be made to the RICS guidance on the ‘Valuation of land for affordable housing’.

Box 18:

Viability assessments should be accompanied with supporting information and evidence. The practitioner will rely upon and form opinions of the various components of a viability assessment in order to arrive at an appropriate professional judgement.

Confidentiality

4.6 Pre-application discussions usually proceed on the basis of treating commercial information provided by a developer (applicant) or their consultant as confidential. In order to encourage openness and transparency in the viability process both at pre- and post-application it is also often the case that the viability reports submitted to a local planning authority are required to be classified as confidential. This is to encourage the applicant to disclose the maximum amount of information which can then be reviewed and reported upon. Local planning authorities should therefore be asked to treat and hold this information on a similarly reciprocal basis and respect disclosure of confidential information could be prejudicial to the developer (applicant) if it were to enter the public domain. Information will usually be disclosed to the LPA adviser but not to the general
public as it may be commercially sensitive.

4.7 Transparency and fairness by all parties is to be recommended in assisting in this process.

4.8 All parties, however, should be aware of the provisions of the Freedom of Information Act and Environmental Information Regulations and also mindful of any conflicts of interest that could taint their advice. Reports may therefore contain the following wording: This viability report is provided on a confidential basis to the Council. We therefore request that the report should not be disclosed to any third parties (other than consultants instructed by the Council to review this report) under the Freedom of Information Act 2000 (sections 41 and 43(2)) or under the Environmental Information Regulations.

Box 19:

It is often the case that viability assessments are required to be classified as confidential as information within them, if disclosed in the public realm, would be prejudicial. LPA advisors, subject to a confidentiality agreement, would be able to scrutinise and report accordingly on such viability assessments.

Mediation, Expert Determination and Arbitration

4.9 Where disputes are unable to be resolved between the applicant’s and the LPA’s respective consultants, the parties may seek the opinion of a third party. This could be through mediation, expert determination or arbitration and could fall at various stages in the planning process. Two basic instances are highlighted as follows:-

(i) in a live or pending appeal, the outcome of any mediation / arbitration can form part of the statement of common ground (SCG). The Inspector (or Secretary of State) is not bound to accept it but parties, if they depart from an SCG, may be at risks of a cost claim.

(ii) If a dispute arises before an appeal, again mediation / arbitration could be available to the parties but this would be non-binding on the LPA.

4.10 The above could be included within planning performance agreements (PPAs) where provisions could be set out for resolving viability disputes. Reasonableness and objectivity are therefore inherent within this process, which this guidance note advocates at all
times.

**Box 20:**

Planning Performance Agreements may contain provisions for resolving financial viability issues.

**Preparing and Scrutinising a Viability Assessment**

4.11 A practitioner, on behalf of a developer or investor, will review all information within a viability assessment and formulate a professional judgement based on an analysis of the results arising from the appraisal.

4.12 Equally, many local authorities will require, in respect of individual developments, an impartial and objective review of the viability assessment submitted as part of a planning application. These should be prepared by suitably qualified practitioners as set out above. It is recommended that once these reports have been prepared, the applicant is provided with a copy (in draft and final forms) to enable responses, if any, to be made to either the local planning authority or directly to the consultant undertaking the independent review.

4.13 The guidance note encourages practitioners to be reasonable, transparent and fair in objectively undertaking or reviewing financial viability assessments. Where possible, differences of opinion should seek to be resolved.

4.14 Viability assessments in the context of this guidance note should be distinguished from providing valuations as defined by the RICS Valuation Professional Standards 2012. Those undertaking viability appraisals in accordance with this guidance are free to make all reasonable and necessary assumptions and forecasts in formulating a judgement as to the viability of a proposed development or in connection with supporting the formulation of Development Plan Documents in local development frameworks. Where deviating from the guidance note it is recommended that this is fully justified and reasoned.

**Box 21:**

The guidance note encourages practitioners to be reasonable, transparent and fair in objectively undertaking or reviewing financial viability assessments. Where possible,
differences of opinion should seek to be resolved.
APPENDICES
Appendix A: Relevance of viability to planning

Preparation of planning policy

A1. The National Planning Policy Framework (NPPF) emphasises the link between delivery and viability. It states that:

‘…. To ensure viability, the costs of any requirements likely to be applied to development, such as requirements for affordable housing, standards, infrastructure contributions or other requirements should, when taking into account of the normal cost of development and mitigation, provide competitive returns to a willing land owner and willing developer to enable the development to be deliverable’
(Para. 173, National Planning Policy Framework)

A2. Good spatial planning should aim to create a framework for private investment and therefore encourage appropriate development in the right locations. If viability is not appropriately considered in setting planning policy objectives and strategies then development can become unnecessarily constrained and policy targets may become undeliverable. Local Plans need to be viable and deliverable in order to be effective and consistent with the NPPF. Key to the concept of effectiveness of planning policy is the requirement that it must be ‘flexible’ and ‘deliverable’. In order to achieve this it is necessary for the viability implications of planning policy objectives to be understood to ensure that they can be delivered. In this sense the concept of viability is highly relevant to spatial planning.

A3. Under the NPPF, Local Plans are considered viable and deliverable by being founded on a robust and credible evidence base as well as being the most appropriate strategy when considered against reasonable alternatives. Viability considerations should form a critical part of the evidence base behind planning policies. In particular, viability is a key consideration when setting affordable housing policy and targets so that targets are deliverable and flexible and set with regard to a robust and credible evidence base including an assessment of economic viability.

A4. Certainty and clarity in policy-making is important, however, at the same time, policies should be able to adapt to changing market circumstances. For example, in considering appropriate levels of affordable housing, policies should allow account to be taken of scheme viability on a site-by-site basis.
A5. The principles of the guidance contained within the NPPF is also relevant to other types of policy documents and guidance, other than simply affordable housing, including in the formulation of area action plans, masterplans and development briefs/frameworks. The mix of land uses advocated and the enabling works set out as being required by area specific guidance documents should be informed by an assessment and understanding of viability.

A6. In recent years it has become common practice for many LPAs to set ‘tariffs’ or ‘standard charges’ for section 106 contributions on new developments through supplementary planning documents (SPDs). As set out in Circular 05/2005: Planning Obligations (July 2005), standard charges should not be applied in blanket form regardless of their actual impacts. The significance of this policy guidance has increased with the translation of policy into legal prerequisites to the reliance on any planning obligation by virtue of regulation 122 of the Community Infrastructure Levy Regulations 2010. It is therefore necessary to understand how viability is assessed so that such policies are flexible to changing market circumstances and scheme specific requirements.

A7. The Community Infrastructure Levy Regulations 2010 also require that by April 2014 tariff-based charges only be levied against development through CIL. With the exception of affordable housing and site-specific mitigation, it will no longer be possible to use section 106 obligations to deliver these kinds of benefits. A prerequisite to the charging of CIL is the adoption by the LPA of a charging schedule. The charging schedule must itself be subjected to an independent examination prior to adoption, and questions of viability will be relevant to determining the credibility of the evidence base used in drawing it up.

**Determination of planning applications (development management)**

A8. Scheme viability is a material consideration in the determination of planning applications as it is inherently linked to ‘delivery’. To ensure delivery of planning objectives at all stages of the economic cycle it is essential that not only planning policy remains flexible but that town planners and other decision-makers have an understanding of how viability is assessed so that consistent decisions can be taken and appropriate weight accorded to viability considerations.

A9. The consideration of financial viability in determining planning applications is particularly important in the context of negotiating section 106 contributions/obligations, including affordable housing. In order for schemes to be delivered, willing landowners require a “competitive return” to release land in the form of uplift in land value reflective of its Market Value whilst allowing the developer an appropriate level of developer profit. Section 106 contributions are a development cost whilst the level of affordable housing sought affects
the GDV. These in turn impact upon residual land value and profit. Particularly where Local Authorities have allocated land for development it is important for all parties to understand these impacts when negotiating section 106 agreements to ensure that development remains attractive. This is recognised in the NPPF. An inconsistent approach to section 106 negotiations can increase development risk, which can deter development coming forward.

A10. At present, the policy tests for planning obligations set out in Circular 05/2005 apply to all land uses. Paragraph B5 requires that planning obligations are only sought where they meet all of the required tests, namely that they must be:

(i) relevant to planning;

(ii) necessary to make the proposed development acceptable in planning terms (now criterion 1 within Regulation 122 of the 2010 Regulations);

(iii) directly related to the proposed development (now criterion 2 within Regulation 122 of the 2010 Regulations);

(iv) fairly related in scale and kind to the proposed development (now criterion 3 within Regulation 122 of the 2010 Regulations; and

(v) reasonable in all other respects.

A11. Financial viability is a key consideration in the above, particularly in determining whether a planning obligation is ‘fairly related in scale and kind to the proposed development’ and ‘reasonable in all other respects’. This is noted in paragraph B10 of Circular 05/2005, which states the following:

‘In some instances, perhaps arising from different regional or site-specific circumstances, it may not be feasible for the proposed development to meet all the requirements set out in local, regional and national planning policies and still be economically viable. In such cases, and where the development is needed to meet the aims of the development plan, it is for the local authority and other public sector agencies to decide what is to be the balance on contributions by developers and by the public sector infrastructure providers in its area supported for example by local taxation’

A12. LPAs should therefore be aware of the cumulative impact of all planning obligations and scheme requirements sought on development viability. It is not just section 106 obligations that can impact on scheme viability. Circular 05/2005 makes it clear that it is for the LPAs to have regard to what may be an appropriate balance of contributions. Other scheme
requirements and planning benefits sought can have a significant effect, including, for example, sustainability requirements.. It is acknowledged that a number of section 106 and other such obligations may be necessary to mitigate the impact of development and make it ‘acceptable’ and ‘sustainable’. It is for decision-makers to recognise the requirement for sustainable development whilst also ensuring development is ‘deliverable’ in accordance with the NPPF. However European and domestic regulatory requirements will have to be met.

A13. Summarised below are key elements that may be required by decision-makers to make the development acceptable but may also impact on scheme viability:

(i) section 106 financial contributions towards social infrastructure, or provision in kind;
(ii) affordable housing (although one could make a case for saying that this is part of (1), it is sufficiently self-contained to be treated on its own);
(iii) the provision of highway improvements;
(iv) design standards, including sustainability measures;
(v) land use mix; and
(vi) abnormal scheme costs, including remediation of ground contamination and costs associated with managing heritage assets.

A14. Given the range of potential demands on a development scheme, the decision-maker will have to balance these competing requirements within the scope of what is viable to ensure that what is deliverable is sustainable and otherwise acceptable in planning terms.

A15. CIL may also be charged by LPAs who have adopted a CIL charging schedule. After April 2014 LPAs will no longer be able to use section 106 obligations to secure planning obligations that are covered by CIL and so the likelihood is that more LPAs will be adopting charging schedules in the run up to 2014 to enable them to recover through CIL.
Wider context

A16. In addition to section 106 contributions required to mitigate the impact of development, in recent years there has been an increasing requirement for developments to contribute towards more general local infrastructure improvements. This has been seen as a way of plugging funding gaps such as through a CIL, and other levies such as in London, the introduction of the Crossrail levy and other more general standard charges/tariffs for infrastructure. Any basis for tariffs must be made on sound evidence and imposed charges need to take account of viability, to ensure that infrastructure requirements do not unreasonably prejudice the delivery of otherwise desirable development proposals.

A17. Decisions of the Secretary of State and inspectors suggest that changing economic circumstances are relevant in the negotiation of affordable housing in assessing viability. Other cases have shown that viability assessments should allow for a reasonable uplift in land value for development to be viable and in order to incentivise ‘delivery’. The NPPF emphasises that willing sellers should receive “competitive returns”. Care should be taken before relying too heavily on previous cases and appeal decisions given the lack of guidance available to decision makers in formulating their views at the time.

A18. In the context of development plans, some recent appeal decisions point to the importance of considering viability when setting affordable housing policy and targets. These cases established the requirement for affordable housing targets to be deliverable and flexible and set with regard to a robust and credible evidence base including an assessment of economic viability. An advice note on how to conduct Plan level viability work is being prepared by the HCA Local Housing Delivery Group.

A19. Case law demonstrates the importance of allowing flexible policy application to take account of changing market circumstances, so that in one case, in considering the ‘soundness’ of a council’s core strategy, the inspector concluded that a policy requiring ‘at least’ 30 per cent of new dwellings to be affordable was not ‘justified’ on the basis of a robust evidence base and could not therefore be proved to be ‘deliverable’. The inspector recommended that the text be amended to delete the words ‘at least’ and that wording was added to allow site-by-site negotiation thereby providing for flexibility. This, therefore, allows sufficient flexibility to take account of changing market circumstances, enabling developers the opportunity to negotiate the level of affordable housing to be offered on a site-by-site basis taking into account scheme viability. Supplementary planning guidance in an adopted supplementary planning document may be appropriate to provide more detailed guidance within the scope of an overarching policy in the core strategy or development policies DPD.
A20. Appeals have been allowed where it has been found that viability reports have convincingly demonstrated that the proposals cannot support any affordable housing and the same held true for a financial contribution in lieu. However, in other instances, appeals have been dismissed if they do not have any or only minimal levels of affordable housing, as they were not considered to be able to bring forward sustainable and well-balanced communities. The scale and nature of the proposals will therefore be a key influencing factor as to whether no or very low levels of affordable housing can be justified in planning terms.

A21. For smaller scale developments which may be completed in a single phase, it would be reasonable to consider what may be an appropriate affordable housing and section 106 offer with regard to market conditions at the time of the application. This is because there is no later phase to capture future value growth. Larger schemes may have longer build out periods with multiple phases and, in such cases, appeal decisions have indicated that it may be reasonable for decision-makers to impose requirements for the viability of the scheme to be considered via a re-appraisal on a phased basis prior to implementation or through the use of projection models.
Appendix B - Property Market Context Overview

B1 Development viability assessments necessitate an accurate evaluation of the key variables in undertaking a development: the estimated value of a scheme when completed and the building cost and other development costs (including professional fees, finance costs and a return to the developer covering risk, i.e. profit) that will be incurred in delivering a scheme. An appropriate return to the landowner or its equivalent having regard to the relevant Market Value of the site will also need to be taken into account. Clearly, as market conditions change the value and cost of a scheme will also change. Hence there are considerable risks involved in implementing development for which the developer must make allowances and be rewarded.

B2 It is also evident that a development viability assessment undertaken when the property market is strong may produce a residual site value (or residual profit when the land has already been acquired) that is very different from that when the market is weak. An understanding of property market conditions and their effect on development viability is therefore important from a planning perspective in both determining planning applications and formulating planning policy. An economic context is also important in considering the impact of the setting of area wide levies and tariffs (e.g. relating to community infrastructure and affordable housing targets, etc.), as well as site specific planning briefs, masterplans and other planning obligation requirements.

B3 The property market, like the general economy, tends to be cyclical. When economic growth is strong companies expand and this feeds through to an increase in employment, an increase in consumer expenditure and an increase in occupier demand for all types of property. Rental and capital values increase and this triggers an increase in planning applications and general development activity. When development viability improves, the ability to meet planning obligations and planning policy is increased.
B4 This cycle goes into reverse when economic growth slows or goes negative and the impact on the property development market is often magnified due to the time it takes to physically construct buildings, particularly large schemes. Development schemes start to tail off at the end of a boom, when occupier demand is strong, and may complete in a much weaker economic climate causing an over-supply of floor space when occupier demand is weak. This may cause property values to fall and development viability to suffer noticeably. When development viability suffers, the ability to meet planning obligations and planning policy is reduced.

B5 All parties to the planning process must be aware of changing market conditions and the effect on development viability. As most development schemes will take a period of a year or more to undertake, local planning authorities need to consider how economic and property market conditions are likely to change during the development process and hence the inevitable uncertainty of development viability. In some instances this may require forecasting or re-appraisals prior to implementation of a development (see section 3 of the guidance note).
Appendix C: Indicative Outline of what to include in a Viability Assessment

Proposed scheme details

- Floor areas:
  - commercial: gross internal area (GIA) and net internal area (NIA)
  - residential: GIA and NSA
- Residential unit numbers and habitable rooms including the split between private and affordable tenures

Gross development value (GDV)

- Any existing income that will continue to be received over the development period
- Anticipated residential sales values and ground rents (and supporting evidence including deductions for incentives)
- Anticipated rental values and supporting evidence
- Yields for the commercial elements of the scheme and supporting evidence
- Details of likely incentives, rent-free periods, voids
- Anticipated sales rates (per month)
- Anticipated grant funding for affordable housing
- Anticipated value of affordable units (with supporting evidence/explanation of how these have been valued and assumptions)
- Deductions from commercial GDV to reach NDC (Stamp Duty Land Tax (SDLT), agents, legal + VAT).

Costs

- Expected build cost (if required, a full QS cost report also showing how costs have been estimated)
- Demolition costs
- Historic costs (as reasonable and appropriate)
- Site preparation costs
- Vacant possession costs
- Planning costs
- Construction timescales, programme and phasing
- Any anticipated abnormal costs
- Rights of light payments / party walls / over sailing rights
- Details of expected funding and finance rates
- Professional fees, including:
  - architect
  - quantity surveyor
  - structural engineer
  - mechanical/electrical engineer
  - project manager
  - letting agent fee
  - letting legal fee
- Site Value (see Section 3 of the guidance)
- Other costs

Additional details for projection based viability assessments
- Expected sales growth
- Expected rental growth
- Expected cost inflation
- Credit rate

Development programme
- Pre-build
- Construction period
- Marketing period

Viability cashflow
- Income/value/capital receipt
- Costs
  - Phasing (where appropriate)

Benchmark viability proxies
• Profit on cost
• Profit on value
• Development yield
• Internal rate of return (IRR)

Planning application details
• Plans/sections/elevations (as relevant)
• Design and access statement

Sensitivity Analysis
• Two way sensitivity analysis
• Scenario analysis
• Simulation analysis

Accompanying Report (basic outline)
• Executive summary
• Contents outline
• Introduction and background
• Description of site location
• Planning policy context
• Description of scheme
• Market information summary
• Build cost and programme
• Methodology and approach
• Outputs and results
• Sensitivity analysis
• Concluding Statement
Appendix D: Refinements to viability Methodology

Development appraisal methodology in practice

D1 Cash flow approaches are widely used in development appraisal to accurately reflect the timing of development expenditure and revenue so that the finance costs can accurately reflect the net cash flows or amount that needs to be borrowed at each stage of the development. The Red Book, GN 7, contains general guidance on discounted cash flow methods.

D2 It is usual practice in a conventional development appraisal to assume a required return in terms of a capital cash sum and to include it in the cash flow on the assumption that the development will be sold on completion and a capital profit received. In contrast, in mainstream capital budgeting theory and in property investment appraisal, the required profit is expressed as a required rate of return. The expected cash flow (excluding any finance costs or profit allowance) is discounted at the required rate of return in order to assess viability, where a purchase price is assumed, or to assess the surplus available to purchase the property. Alternatively, the cash flow can be discounted at a discount rate which gives a zero net present value (NPV). This discount rate represents the scheme’s internal rate of return (IRR) which can be compared with the required rate of return reflecting the level of risk.

D3 It is also common practice in conventional development appraisals to assume all-debt financing (i.e. all development costs are financed by borrowing). Again, this is in contrast to mainstream project appraisal where the value of the project’s equity and the value added by financing are treated separately. When bidding for investments, it is common practice for institutional investors to use a cash flow analysis to estimate the present value of the project cash flows. In the appraisal of standing investments, the present value is essentially a residual surplus calculated in the same way as a residual site value, using a discounted cash flow technique. However, in this broader property investment context, cost of finance is not used as a discount rate and profit is not assumed as a margin on expected sale value or cost. Instead, in line with mainstream capital budgeting theory and consistent with wealth maximisation, profit requirement and opportunity cost are embedded in a required rate of return.

D4 The key point is that there is little direct connection between the rate at which a company can borrow and the appropriate discount rate to be applied to a particular project. This is particularly so when the expected cash flows are subject to a high degree of risk, as in many property developments. The mainstream approach to dealing with financing in project
evaluation is to discount the projects at the weighted average cost of capital (WACC) or discount the equity at the cost of equity.

**Inflation of values and costs**

**D5** In this guidance note it is emphasised that residual valuations can be sensitive to small changes in the key variables of value and building cost and how great care needs to be taken when undertaking a residual valuation. There is, by definition, uncertainty in any residual valuation, as estimates have to be made of the value of the scheme as completed and the costs of a scheme which may vary as the development progresses. Where possible a developer may try and pre-let/pre-sell all or part of the scheme before development commences and use a fixed price building contract. If this is possible there will be much greater certainty about total scheme values and costs, a lower required return and hence greater certainty regarding the residual site value. However, it is rarely possible to achieve all these objectives and where it is possible there is a price to pay in terms of discounts on the rental and capital value in particular. Where a developer anticipates an improving property market, pre-lets and pre-sales may lessen risks but also lessen the eventual return.

**D6** This highlights the impact that inflation in values and costs can have on a development appraisal. It is common practice (but not universal practice) that for smaller schemes, where the development period is limited to a year or two, residual appraisals are undertaken using current costs and values as these are easier to estimate and are, therefore, assumed to be more certain/robust. However, the amount that developers allow for their return for risk and profit may vary to reflect how values and costs are expected to change. Nevertheless, this implicit approach is somewhat crude as even if a scheme takes say two years to develop, rental/capital values may be very different by the time the scheme is completed than they are before construction commences.

**D7** For large schemes with a lengthy development period, or for even larger schemes where phased development is likely, the effect of inflation needs to be considered. Even if the total percentage increase in building costs and capital values for a development are identical, the residual site value would also increase by the same percentage amount. Where capital values increase in percentage terms by more than the increase in building costs there will be a disproportionate increase in the residual site value. Where the reverse occurs there will be a disproportionate decrease in the residual site value. However, arguably, the former is more likely to occur than the latter for commercial schemes as speculative developments tend to be let and sold at the end of the development period, therefore benefiting from growth in values through most of the period, whereas building costs are incurred and paid at stages
during the development period and land/site costs are paid as a fixed cost before building commences.

D8 Predicting or forecasting values for rents, yields (for commercial/industrial schemes) and costs is difficult, even over short time periods. The potential volatility of the market, and the development viability risks which result, are factors that a developer has to consider, either explicitly or implicitly when undertaking a residual appraisal. These are also factors that planners need to consider when ascertaining the level of affordable housing and/or planning obligation payments the development can support both now and in the future. Development viability will clearly be affected by the level and the movement of capital values and building costs.

D9 For large-scale developments taking many years, to undertake some form of trend forecasting of values and costs is desirable (plus some allowance for an increase up to, or decrease down to, trend levels, so that the effects of inflation can be correctly taken into account). If current values and costs are used the residual land value on completion of development, or phases of development, when discounted back to the present day will be noticeably lower than if the effects of inflation are taken into account. Arguably this will not give an accurate assessment of the true appraisal of the site.

D10 A related point to a consideration of the effects of inflation in a development appraisal is the finance or discount rate used (it should be noted that where the guidance refers to the IRR of a project – see Appendix F – this is on a without-finance basis or in other words a project IRR being consistent with mainstream capital budgeting theory and therefore what is set out in this paragraph and those that follow is only relevant where finance is taken into account in the return or discount rate. A developer might also include finance after an initial project appraisal to estimate the equity IRR or where the cashflow might be discounted at a WACC). It is normal practice in a development appraisal to allow for the cost of borrowing money to pay for development costs as they occur (net costs in each cash flow period) where say, profit on cost or value is a measure of return. The accumulated total costs are then subtracted from the estimated value of the scheme and then this residual site value is discounted at the finance rate to give the present day value of the site. This is the value of land that will be paid when the site is acquired before development commences. An alternative approach, which will give the same residual site value, is to calculate the net cash flow in each period (costs incurred less any sales income received) and then discount each cash flow back to the present day at the appropriate finance rate (i.e. the cost of borrowing money).
The finance rate charged by a bank will reflect current interest rates plus a margin to reflect the risk of lending, etc. The interest charged will be repaid out of the actual income received by the developer from sales of completed parts of the development. These sales will reflect inflation, as will the interest rate charged. If inflation is not explicitly allowed for in the residual valuation it is, arguably, mathematically incorrect to allow for a finance rate that reflects inflation. Over short time periods this inaccuracy may be small, but for larger schemes with lengthy development periods this inaccuracy could be much greater.

Two alternative approaches are, therefore, recommended for major development schemes in particular. One approach is that some form of explicit inflationary projection of costs and values should be undertaken, coupled with a market finance or discount rate. Alternatively current values and costs should be used together with a net of inflation finance rate or discount rate. It will be up to the practitioner as to which of the two approaches is more applicable to the scheme in question.
Appendix E
Application of Underlying Concepts within the Guidance

This Appendix is aimed at providing further understanding of the guidance in terms of Site Value, types of developer and the constituent elements of the residual appraisal. There are many uses for viability appraisals in both a policy and development control context (see paragraph 1.10 of the guidance). Not all rely upon residual appraisals, but many do use this approach and methodology.

This Appendix is set out as follows:-

1. Market Value and Land Supply;
2. Types of Developer; and
3. Constituent Parts of the Residual Appraisal;

Where appropriate, reference is made to the main text of the guidance in respect of terminology and principles.

E1 Market Value and Land Supply

E1.1 The RICS Valuation – Professional Standards 2012 (Red Book) definition of Market Value is as follows:-

“The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after properly marketing and where the parties had each acted knowledgeably, prudently and without compulsion.”

E1.2 The Red Book also deals with the situation where the price offered by prospective buyers generally in the market would reflect an expectation of a change in the circumstances of the property in the future. This element is often referred to as ‘hope value’ and should be reflected in Market Value. The Red Book provides two examples of where the hope of additional value being created or obtained in the future may impact on the Market Value:
“the prospect of development where there is no current permission for that development; and

the prospect of synergistic value arising from merger with another property or interests within the same property at a future date.”

E1.3 The guidance at paragraph 3.8 seeks to provide further clarification in respect of the first of these by stating “that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan.”

E1.4 The second bullet point in paragraph 1.2 above is particularly relevant where sites have been assembled for a particular development. The guidance refers to this at paragraph 3.21.

E1.5 It should be noted that “hope value” is not defined in either the Valuation Standards. That is because it is not a basis of value but more a convenient way of expressing the certainty of a valuation where value reflects development for which permission is not guaranteed to be given but if it was, it would produce a value above current use.

E1.6 To date, in the absence of any guidance, a variety of practices have evolved which benchmark land value. One of these, used by a limited number of practitioners, has been to adopt Current Use Value (CUV) plus a margin or a variant of this (Existing Use Value (EUV) plus a premium). The EUV / CUV basis is discussed below. The margin is an arbitrary figure often ranging from 10% to 40% above CUV but higher percentages have been used particularly in respect of greenfield and rural land development.

E1.7 In formulating this guidance, well understood valuation definitions have been examined as contained within the Red Book. In arriving at the definition of Site Value (being Market Value with an assumption), the Working Party / Consultant Team of this guidance have had regard to other definitions such as EUV and AUV in order to clarify the distinction necessary in a financial viability in a planning context. Existing Use Value is defined as follows:-

“The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after properly marketing and where the parties had each acted knowledgeably, prudently and without compulsion assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses and any other characteristics of the property
that would cause Market Value to differ from that needed to replace the remaining service potential at least cost."

E1.8 It is clear the above definition is inappropriate when considered in a financial viability in planning context. EUV is used only for inclusion in financial statements prepared in accordance with UK accounting standards and as such, hypothetical in a market context. Property does not transact on an EUV (or CUV) basis.

E1.9 It follows that most practitioners have recognised and agreed that CUV does not reflect the workings of the market as land does not sell for its CUV, but rather at a price reflecting its potential for development. Whilst the use of CUV plus a margin does in effect recognise hope value by applying a percentage increase over CUV it is a very unsatisfactory methodology when compared to the Market Value approach set out in the Guidance and above. This is because it assumes land would be released for a fixed percentage above CUV that is arbitrary inconsistently applied and above all does not reflect the market.

E1.10 Accordingly, the guidance adopts the well understood definition of Market Value as the appropriate basis to assess Site Value, subject to an assumption. This is consistent with the NPPF, which acknowledges that “willing sellers” of land should receive “competitive returns”. Competitive returns can only be achieved in a market context (i.e. Market Value) not one which is hypothetically based with an arbitrary mark-up applied, as in the case of EUV (or CUV) plus.

E1.11 So far as alternative use value is concerned, the Valuation Standards at VS6.7 state “where it is clear that a purchaser in the market would acquire the property for an alternative use of the land because that alternative use can be readily identified as generating a higher value than the current use, and is both commercially and legally feasible, the value for this alternative use would be the Market Value and should be reported as such.” In other words, hope value is also reflected and the answer is still Market Value. Again, in arriving at Market Value via alternative use value, the planning status of the land / building set out in paragraph 3.8 should be applied. This is also consistent with the NPPF for “willing sellers” to receive “competitive returns”.
Finally the above diagram\textsuperscript{13} (ref adapted from Fraser 1993 add as a footnote) represents the supply and demand curve in economic terms for development land and the prices at which it will transact assuming changes in demand. As can be seen, there is significant downside inflexibility in terms of site values. Owners neither have to sell, nor indeed, wish to sell at lower prices and therefore will tend to hold on to their land holdings. It follows that the short run supply curve for development sites is significantly more elastic below the current price than it is above. Changes in demand having regard to planning policy such as levels of affordable housing can see relatively sharp rises in values on the upside but relatively small movements on the downside. It is clear that as the price moves closer to the CUV the less likely the land will be delivered to the market and simply held by landowners. This would also imply that prices for land in the market cycle are more volatile as the peak of the market is reached than when the market is in recession. Property development which will influence the price to be paid for a particular site is of course subject to many uncertainties and risk. Developers will have different views (and interpretations on the application and interrelationship between planning policies) as to how any site will be built out and this will affect the level of pricing and the range which may be bid for individual sites on a competitive basis to a willing seller. Real options analysis also underpins the economic position outlined above in terms of the supply of land to the market\textsuperscript{14}.

\begin{itemize}
  \item \textsuperscript{13} Adapted from W.D. Fraser “Principles of Property Investment and Pricing (2\textsuperscript{nd} Edition)
  \item \textsuperscript{14} RICS Research “A review of the practical uses of real property options” (Volume 5 No. 1 April 2005)
\end{itemize}
E2 Types of Developer

E2.1 The guidance has differentiated between the land owner (delivering land to the market) and the developer (implementing development) in respect of defining viability (see 2.1 of the guidance). In practice, the developer may also be the land owner (and vice versa). Developers also take on many forms of which the most common are highlighted below:

- **Property company / developer:** A company that selects projects, assesses risk, promotes concepts, secures land, attracts occupiers and achieves a final development for onward sale. This occurs across most development sectors including residential, commercial (offices, retail and industrial) and mixed use;

- **Land and estate businesses:** Companies that manage large estates of land, for example historic estates, national utilities and power companies. Whilst acting as a developer they may have a primary focus on other mainstream activities (long term management and improvement of the estate or say the utility function);

- **Public sector:** Central government, local government, agencies and other quasi-public sector parties are all developers of property, often within the objective of some form of owner occupation, but maybe as joint venture partners (see below) as a land owner;

- **Joint ventures:** Companies can be created to pursue development, for example joint ventures, special purpose vehicles and local asset backed vehicles. Some of these have a direct link to the functions of central or local government to promote beneficial redevelopment and regeneration, and could include Private Finance Initiative / Public Private Partnership schemes; and

- **Investment company:** A business that holds long term or strategic investments in land and property, for example pension funds and insurance companies, where development is a longer term objective.

- **Institutional / Strategic Investor:** long term holders of property with future development potential.
E3 Constituent Parts of the Residual Appraisal

E3.1 Viability appraisals will vary according to the project in question. Appendix C provides an indicative outline of what to include in a viability assessment. This section considers some of the general key elements in a little more detail, including:

- Gross development value – or sales proceeds;
- Land / property value (Site Value);
- Standard site development costs (demolition and construction);
- Abnormal development costs (including site remediation);
- Planning obligations (including affordable housing provision);
- All professional fees (architects, quantity surveyors, etc.);
- Marketing and disposal costs (including agents and legal fees);
- Finance costs; and
- Profit return (profit on cost / value, internal rate of return, development yield, etc.)

E3.2 Most viability appraisals comprise of a Summary Page as well as a Cash flow. The Summary Page will provide an outline of the Gross Development Value (sales value) and show the various costs which have been deducted to arrive at the residual land value or a profit return. The cash flow sets out the detailed cash movements, including timing of cost outlays (expenditure) and revenue receipts (income). It is an important tool in preparing a development appraisal and in reality will provide the primary focus for the developer.

Gross Development Value or Sales Proceeds

E3.3 This is widely referred to as the Gross Development Value (GDV). Different types of development may use different approaches, for example:

- for residential sales, the aggregated values of the individual properties;
- for an office block, there may be an additional assumption that the completed development is let and income producing rather than being vacant and available for sale or letting; and
• for commercial property, a slightly more complex Investment Valuation (rent multiplied by yield) approach to establishing the value may be used.

**Land / Property Value (Site Value)**

**E3.4** This is set out in the main text of the Guidance (Section 3) and above in Section 1 of this Appendix.

**Development Costs**

**E3.5** For any development, a critical influence on its viability will be the cost of preparing the surface of the site for development and the contract cost of final construction. A reasonably accurate estimation of the building costs at the valuation date is a major component in a residual valuation.

**E3.6** Development Appraisals are very sensitive to variations in the estimated costs however, the accuracy with which costs can be assessed may vary greatly according to the specific site characteristics for example the intention to retain specific structures.

**E3.7** The choice of procurement route imposes differing responsibilities. Fixed price contracts are only fixed to the extent of the works outlined in the contract. It allows for inflation and amendments can be made if variations to the specification are made. It should be noted that even “current day” build costs (as tendered) allows for some degree of price inflation during the contract. For developments of long duration, additional build cost inflation will need to be allowed for and a growth / projection approach may be more appropriate.

**E3.8** In all costs the inclusion of a contingency allowance to cater for the unexpected is essential. The amount of this is usually reflected as a percentage of the building contract sum and is dependent upon the nature of the development, the procurement method and the perceived accuracy of the information obtained.

**Abnormal Site / Historic Development Costs**

**E3.9** A typical viability assessment includes provisions for exceptional costs. This might include an unusual sewerage connection facility, high levels of site contamination and the need for extensive remedial works, flooding, site boundary and stabilisation works (particularly if there are substructure obstacles to overcome). These exceptional site costs, or “abnormals” inflate costs as well as adding to the timeframe for the delivery of a scheme. Historic costs may also be reasonable and appropriate.
E3.10 Again, these are dealt with in the main text of the guidance and Appendix A.

**Professional Fees and Expenses Costs**

E3.11 Fees and expenses can vary significantly according to the size and complexity of the development. The *development team* normally includes:

- a planning consultant
- an environmental contractor
- an architect
- a quantity surveyor
- a funding surveyor
- a civil and / or structural engineer

- specialist services may be supplied as appropriate by mechanical and electrical engineers, landscape architects, traffic engineers, acoustic consultants, project managers, health and safety and other disciplines, depending on the nature of the development

**Finance Costs**

E3.12 Most development projects are funded from interest paying borrowings that are highly sensitive to timescales and risks. Interest arises on land acquisition and development costs. The rate of interest reflects levels in the market for the type of scheme involved. It is either paid when due or deferred (rolled up) throughout the projected programme. Conventionally the interest is compounded, either quarterly or annually in line with the current market practice. Delay, added complications or shifts in the money markets, can all therefore have an important impact on finance costs.

E3.13 Viability appraisals generally assume that projects are fully funded by borrowing money. This is often referred to a 100% gearing. Even where the funder has provided only part of the finance debt and the developer has used his own funds for the balance (equity), the appraisal should reflect the total cost of the funding.
E3.14 Normally interest is treated as a development cost up to the assumed letting date of the last unit, unless a forward sale agreement dictates otherwise. For residential developments, sales of individual units may occur at various stages during the development and appropriate assumptions have to be made regarding cash flow, both inward and outward. The approximate timings for the pre-construction, principal construction and post construction periods have to be determined.

E3.15 It should be noted that interest costs are relevant when using, in particular, profit on cost and profit on value measures of return. When the internal rate of return (IRR) is used as a project IRR, it is usual to state this excluding finance, in common with normal corporate practice (see Appendix B).

**Profit Return**

E3.16 The nature of the development and prevailing practice in the market for the sector influences the target profit margin, or rate of return. This varies for each development. Commercial developers tend to seek a return on cost, usually expressed as a percentage of the total development cost. The residential sector seeks a return on the Gross Development Value, commonly referred to as the sales margin. Both have a direct relationship with one another and are therefore wholly interchangeable as a return proxy. Increasingly and particularly in respect of large scale or lengthy developments, the internal rate of return is used. This is important when using projection (growth models).
## Appendix F: Glossary of terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Affordable housing</strong></td>
<td>All housing provided at below Market Value or market rental value. May include various forms of tenure including: social rent, affordable rent, target rent, intermediate housing, shared equity, etc.</td>
</tr>
<tr>
<td><strong>Acquisition / Disposal Costs</strong></td>
<td>Cost associated with the acquisition or disposal of property usually including legal, agent and stamp duty land (SDLT) costs.</td>
</tr>
<tr>
<td><strong>Alternative Use Value</strong></td>
<td>Where an alternative use can be readily identified as generating a higher value for a site, the value for this alternative use would be the Market Value with an assumption as defined for Site Value for financial viability assessments for scheme specific planning applications (see also Appendix E)</td>
</tr>
<tr>
<td><strong>Benchmark</strong></td>
<td>A comparator for either the outputs or inputs into the appraisal, i.e. site value or developer’s return, etc.</td>
</tr>
<tr>
<td><strong>Building Cost Information Services (BCIS)</strong></td>
<td>A subscriber service set up in 1962 under the aegis of RICS to facilitate the exchange of detailed building construction costs. The service is available from an independent body to those of any discipline who are willing and able to contribute and receive data on a reciprocal basis.</td>
</tr>
<tr>
<td><strong>Building costs indices</strong></td>
<td>A series of indices published by the Building Cost Information Service (BCIS) relating to the cost of building work. They are based on cost models of ‘average building’, which measure the changes in costs of labour, materials and plant which collectively cover the basic cost to a contractor.</td>
</tr>
<tr>
<td><strong>Capital value</strong></td>
<td>The value of a building or land as distinct from its rental value.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>-------------------------------------------</td>
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</tr>
<tr>
<td>Cash flow</td>
<td>The movement of money by way of income, expenditure and capital receipts and payments during the course of the development.</td>
</tr>
<tr>
<td>CIL</td>
<td>Community Infrastructure Levy</td>
</tr>
<tr>
<td>Clawback</td>
<td>See Overage</td>
</tr>
<tr>
<td>Comparable Evidence</td>
<td>A property used in the valuation process as evidence to support the valuation of another property. It may be necessary to analyse and adjust in order to put it in a suitable form to be used as evidence for comparison purposes</td>
</tr>
<tr>
<td>Contingent liabilities</td>
<td>See Re-appraisal</td>
</tr>
<tr>
<td>Counterfactual scenario</td>
<td>A scheme that is not that which is being proposed by a developer, but reflects alternative interpretation of planning policy, which can then be financially appraised and compared with the proposed scheme.</td>
</tr>
<tr>
<td>Current Use Value</td>
<td>Market Value for the continuing existing use of the site or property assuming all hope value is excluded including value arising from any planning permission or alternative use. This also differs from the Existing Use Value. It is hypothetical in a market context as property generally does not transact on a CUV basis</td>
</tr>
<tr>
<td>Current Use Value (plus a premium)</td>
<td>Used by some practitioners for establishing Site Value. The basis is as with CUV but then adds a premium (usually 10% to 40%) as an incentive for the landowner to sell. It however does not reflect the market and is both arbitrary and inconsistent in practical application.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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</tr>
<tr>
<td>Deferred payments</td>
<td>See Overage</td>
</tr>
<tr>
<td>Depreciation</td>
<td>The rate of decline in rental / capital value of an asset over time relative to the asset valued as new with a contemporary specification.</td>
</tr>
<tr>
<td></td>
<td>See also obsolescence</td>
</tr>
<tr>
<td>Development appraisal</td>
<td>A financial appraisal of a development to calculate either: (i) the residual site value (deducting all development costs, including an allowance for the developer’s profit/return, from the scheme’s total capital value); or (ii) the residual development profit/return (deducting all development costs, including the site value/cost, from the scheme’s total capital value).</td>
</tr>
<tr>
<td>Developer’s profit</td>
<td>The amount by which, on completion or partial completion of a development, the estimated value or the price realised on sale of a developer’s interest exceeds (or is less than) the total outlay, including such figure for the land as is considered appropriate in the circumstances (including accrued interest).</td>
</tr>
<tr>
<td>Developer’s return for risk and profit</td>
<td>This return is commonly expressed as profit on cost; profit on value; development yield; and internal rate of return (see individual definitions). There are other less used proxies which may be referred to in certain circumstances. Each is appropriate as a method of interpreting viability. In an appraisal the return incorporates the amount which is allowed to cover both: (a) an estimate of the sum needed to reflect the risk element between the appraisal date and the completion of the development programme; and (b) an amount to meet the developer’s requirement for profit on the venture, including an allowance for overheads.</td>
</tr>
</tbody>
</table>
Development risk - Being the risk associated with the implementation and completion of a development including post-construction letting and sales.

Development yield - Rental income divided by actual cost incurred in realising the development.

Discounted cash flow (DCF) - Discounted cash flow. See internal rate of return or net present value below.

Discount rate - The rate, or rates, of interest selected when calculating the present value of some future cost or benefit.

Estimated rental value (ERV) - An estimate of the likely rental income to be generated from the scheme when fully let.

Existing Use Value (EUV) - The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses and any other characteristics of the property that would cause Market Value to differ from that needed to replace the remaining service potential at least cost.

It is an accounting definition of value for business use and as such, hypothetical in a market context as property generally does not transact on an EUV basis.

Existing use value (plus a premium) - Used by some practitioners for establishing Site Value. The basis is as with EUV but then adds a premium (usually 10% to 40%) as an incentive for the landowner to sell. It however does not reflect the market and is both arbitrary and
inconsistent in practical application.

**Gross development value (GDV)** - The aggregate Market Value of the proposed development assessed on the special assumption that the development is complete as at the date of valuation in the market conditions prevailing at that date.

**Gross development cost (GDC)** - The cost of undertaking a development which normally includes the following:

- acquisition costs;
- site-specific related costs;
- build costs;
- fees and expenses;
- interest or financing costs;
- holding costs during the development period.

A full list of typical costs is contained in VIP 12. See also Appendices C and E.

**Gross external area (GEA)** - The aggregate superficial area of a building taking each floor into account. As per the RICS Code of Measuring Practice this includes: external walls and projections, columns, piers, chimney breasts, stairwells and lift wells, tank and plant rooms, fuel stores whether or not above main roof level (except for Scotland, where for rating purposes these are excluded); and open-side covered areas and enclosed car parking areas; but excludes: open balconies; open fire escapes, open covered ways or minor canopies; open vehicle parking areas, terraces, etc.; domestic outside WCs and coalthouses. In calculating GEA, party walls are measured to their centre line, while areas with a headroom of less than 1.5m are excluded and quoted separately.

**Gross Internal Area (GIA)** - Measurement of a building on the same basis as gross external area, but excluding external wall thicknesses.
**Holding cost**
- The cost involved in owning a site or property which may include such items as interest on finance used to acquire the asset, maintenance costs, empty rates, etc.

**Hope value**
- Any element of open Market Value of a property in excess of the current use value, reflecting the prospect of some more valuable future use or development. It takes account of the uncertain nature or extent of such prospects, including the time which would elapse before one could expect planning permission to be obtained or any relevant constraints overcome, so as to enable the more valuable use to be implemented.

**Inflation**
- As measured by the consumer or retail price index or property related index including BCIS index.

**Interest Rate**
- The rate of finance applied in a development appraisal. As most appraisals assume 100% financing, it is usual for the interest rate to reflect the total cost of finance and funding of a project, i.e. the combination of both equity and debt in applying a single rate.

**Internal rate of return (IRR)**
- The rate of interest (expressed as a percentage) at which all future cash flows (positive and negative) must be discounted in order that the net present value of those cash flows, including the initial investment, should be equal to zero. It is found by trial and error by applying present values at different rates of interest in turn to the net cash flow. It is sometimes called the discounted cash flow rate of return. In development financial viability appraisals the IRR is commonly, although not always, calculated on a without-finance basis as a total project IRR.

**Local planning authority (LPA)**
- The determining authority.
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risk</td>
<td>The uncertainty resulting from the movement of the property market irrespective of the property being developed.</td>
</tr>
<tr>
<td>Market risk adjusted return</td>
<td>The discount rate as varied so as to reflect the received risk of the development in the market.</td>
</tr>
<tr>
<td>Market Value (MV)</td>
<td>The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.</td>
</tr>
<tr>
<td>Market value growth</td>
<td>The forecast growth of the capital value of the scheme.</td>
</tr>
<tr>
<td>Net development value (NDV)</td>
<td>The GDV less acquisition costs.</td>
</tr>
<tr>
<td>Net cash flows</td>
<td>The free cash flows of the scheme after costs and taxes.</td>
</tr>
<tr>
<td>Net internal area (NIA)</td>
<td>The usable space within a building measured to the internal finish of structural, external or party walls, but excluding toilets, lift and plant rooms, stairs and lift wells, common entrance halls, lobbies and corridors, internal structural walls and columns and car parking areas.</td>
</tr>
<tr>
<td>Net present value (NPV)</td>
<td>The sum of the discounted values of a prospective cash flow, where each receipt/payment is discounted to its present value at a discount rate equal to a target rate of return or cost of capital. In the case of an investment the formal definition of NPV is net of the initial investment, but the term is more commonly used colloquially to describe the NPV of the future cash flows (net income) and terminal value, which figure is compared with the purchase price in order to reach an invest-or-not decision. In the case of a development the term is more commonly used colloquially to describe the NPV of the future cash flows (costs less income, i.e. net income) and terminal (i.e. sale) value,</td>
</tr>
</tbody>
</table>
which figure is compared with the purchase price of the site in order to reach an invest-or-not decision.

**Net present value method**
- A method used in discounted cash flow analysis to find the sum of money representing the difference between the present value of all inflows and all outflows of cash associated with the project by discounting each at the criterion rate, e.g. the cost of capital.

**Obsolescence**
- Categorised as being a combination of functional, locational and physical factors largely a result of changing requirements that a particular property is no longer able to fulfil.

See also Depreciation.

**Opportunity cost**
- The return or benefit of the next best choice foregone by pursuing an alternative action.

**Outturn (growth) model**
- A development appraisal that has been adapted to forecast various inputs, usually both in respect of values and costs.

**Overage (clawback)**
- A practice referred to as overage, clawback or deferred payments, and employed as a post development appraisal of the scheme in question.

**Oversailing licences**
- Where a crane, for example, is required to use air space over neighbouring properties.

**Party wall costs**
- The practice is not considered appropriate as it cannot take account of risk, uncertainty and funding at the point of implementation. If re-appraisals are to take place, the guidance recommends this is undertaken prior to implementation (see Re-appraisal).

**Planning obligation**
- Provided for under section 106 of the *Town and Country Planning Act 1990*, usually in connection with the grant of planning permission for a private development project. A
benefit to the community – either generally or in a particular locality – to offset the impact of development, e.g. the provision of open space, a transport improvement or affordable housing. The term is usually applied when a developer agrees to incur some expenditure, surrender some right or grant some concession which could not be embodied in a valid planning condition.

Pre-lets and pre-sales - Where a developer of a scheme, usually prior to implementation, has agreed lettings with occupiers or sales of part of the whole of the development.

Profit on cost - The profit of the scheme expressed as a percentage of cost. This has a direct relationship to profit on value.

Profit on value - The profit of the scheme expressed as a percentage of the scheme’s value. This has a direct relationship to profit on cost.

Property specific risk - The uncertainty attached to the intrinsic development of a site or property in addition to the general market risk.

Rateable value - The figure upon which the uniform business rate is charged.

Red Book - The RICS Valuation – Professional Standards 2012

Rental value - The income that can be derived under a lease or tenancy for use of land or a building.

Re-appraisals - Appraisals undertaken prior to implementation of a development in order to assess viability before actual development.

Residual appraisals - See development appraisals.

Residual site value or residual - The amount remaining once the GDC of a scheme is deducted from its GDV after an appropriate return has
land value

Residual valuation - A valuation/appraisal of land using a development appraisal.

Return (on capital) - The ratio of annual net income to capital derived from analysis of a transaction and expressed as a percentage.

Review Mechanisms - See Re-appraisals.

Rights to light - An easement which entitles the owner of the dominant tenement to adequate natural light to a window from the adjoining land.


RSL / RP - Registered Social Landlord / Registered Provider.

Sensitivity analysis - A series of calculations resulting from the residual appraisal involving one or more variables, i.e. rent, sales values, build costs which are varied in turn to show the differing results.

Sensitivity Simulation - A simulation analysis considers the probability of outcomes given certain variances applied to key inputs within the financial appraisal through a stochastic process. It can quantify the robustness of a development in terms of various outputs including risk and return.

Site Value (for financial viability assessments for scheme specific planning applications) - Market Value subject to the following assumption: that the value has regard to development plan policies and all other material planning considerations and disregards that which is contrary to the development plan.

Site Value (for area wide financial viability assessments) - Site Value (as defined above) may need to be further adjusted to reflect the emerging policy/CIL charging level. The level of the adjustment assumes that site delivery would
not be prejudiced. Where an adjustment is made, the practitioner should set out their professional opinion underlying the assumptions adopted. These include, as a minimum, comments on the state of the market and delivery targets as at the date of assessment.

(for first assumption of Site Value for financial viability assessments for scheme specific planning applications - see also paragraph 3.10)

**Social and intermediate housing** - As defined by government guidance or in statute.

**Speculative developments** - Developments which are commenced prior to any agreed sales or lettings.

**Standing investments** - Properties which are income producing usually with a tenant in occupation.

**Synergistic value** - See Appendix E.

**Target profit** - The level of return considered to be the minimum acceptable.

**Tender price indices** - A series of indices, published by the Building Cost Information Service (BCIS), relating to the level of prices likely to be quoted at a given time by contractors tendering for building work, i.e. it reflects the impact of market conditions on the tenderer's decision whether to bid at a high, low or average level relative to building costs.

**Threshold Land Value** - A term developed by the Homes and Communities Agency (HCA) being essentially a land value at or above that which it is assumed a landowner would be prepared to sell. It is not a recognised valuation definition or approach.

**‘Toolkit’ appraisal** - A generic term often used when undertaking financial
viability testing in planning. Sometimes applied to financial models that have been developed to try and standardise the exercise when presenting to local authorities, e.g. the HCA Development Appraisal Toolkit (DAT).

**Vacant possession**
- The attribute of an empty property which can legally be exclusively occupied and used by the owner or, on a sale or letting, by the new owner or tenant.

**Viability assessments/financial viability**
- A report including a financial appraisal to establish the profit or loss arising from a proposed development. It will usually provide an analysis of both the figures inputted and output results together with other matters of relevance. An assessment will normally provide a judgement as to the profitability (or loss) of a development.

**Weighted average cost of capital (WACC)**
- The minimum return a company should earn in respect of an asset by reference to relative weight of equity and debt within its capital structure.

**Yields**
- As applied to different commercial elements of a scheme (i.e. office, retail, etc.) and is usually calculated as a year’s rental income as a percentage of the value of the property.
Appendix G: FAQs by Planning Officers

G1 What should a financial viability assessment (FVA) look like and what should be expected?

A FVA will vary from planning application to planning application. It should however contain a level and detail of information that is reasonable and appropriate in the circumstances. The FVA will contain a number of sections and should, in the first instance, clearly set out what is being tested, the methodology and approach, and link it back to the underlying planning policy framework. All inputs should be justified in the financial model with agents and professional reports appended as necessary. The outputs from the appraisal should be analysed and tested in order to reach a fully justified conclusion. (Reference: Section 2, paragraph 2.17, paragraphs 4.3 and 4.4, and Appendix C)

G2 Does a FVA need to be undertaken by a Chartered Surveyor?

A Chartered Surveyor or suitably qualified professional practitioner can undertake FVAs. Where considering the underlying site value, a Chartered Surveyor is likely to be beneficial to the process, given the core skill sets required. (Reference: Section 3 and paragraph 4.3)

G3 Does the FVA need to include a “toolkit” model such as the HCA EAT model or similar?

The guidance does not advocate a particular financial model. It is up to the practitioner in the first instance to use what they consider to be the most appropriate model for the application scheme being financially assessed. (Reference: Paragraph 2.19)

G4 Is it necessary to employ a viability consultant to undertake a review of the applicant’s FVA?

Given the complexities of development appraisals, it is recommended in most cases that an applicant and/or local authority seek advice from a suitably qualified practitioner. (Reference: paragraph 4.3 and Section 2)
G5  How much influence can be exerted over the consultant in terms of the Council’s aspiration for negotiation purposes?

The guidance recommends that practitioners are reasonable, transparent and fair in objectively undertaking or reviewing FVAs. Where possible, differences of opinion should be resolved between consultants acting for the applicant and the Council. Once the financial position has been established and agreed between consultants, this does not preclude further negotiation between the Council and the applicant having regard to all material planning considerations. (Reference: paragraphs 4.6 to 4.9)

G6  The FVA has used an EUV plus approach to land value. Is this wrong?

The guidance recommends the FVAs should be undertaken having regard to Market Value with an assumption. Whilst the practice of using EUV plus is flawed, it is perfectly possible that both approaches could end up with the same answer as to the Site Value for the purposes of the FVA. (Reference Section 3, paragraphs 3.11 to 3.19, Appendix E)

G7  As an authority, the core housing strategy is based on an EUV plus basis rather than MV (with assumptions), which is used in the site specific appraisal. How are the two reconciled?

The core strategy is an area wide document which should be tested accordingly including Market Value (with special assumptions). It should also accord with the NPPF. Site specific appraisals are again appraised having regard to the intrinsic nature of the development and Market Value (with assumption). Even where a site specific appraisal has adopted EUV plus in accordance with a core strategy, values may or may not be reconciled. Professional advice is recommended should this become an issue. (Reference: Appendix E)

G8  The regional authority has intimated they wish to see FVAs based on an EUV plus basis. How does this fit with the RICS GN?

The regional authority is perfectly entitled to produce guidance or otherwise advocating how they wish to see the basis of FVAs undertaken. It should also accord with the NPPF. Where an authority seeks to differ from the RICS GN, for example, in respect of Site Value, it is recommended that the authority sets out their reasons and rationale for justifying a
departure from the RICS GN in order to assist applicants and Inspectors at Inquiries.  
(Reference: Appendix E)

G9  **Is the RICS GN consistent with the NPPF?**

The guidance is in accordance with the NPPF. (Reference: Appendix A)

G10  **Can the applicant insist on parts, or the entirety, of the FVA remaining confidential?**

FVAs often contain confidential information which, if released to the public or discussed in the public forum, would be prejudicial to an applicant. It has become standard practice, backed up by recent case law, for commercially sensitive information to be classified as confidential. This may result in parts of the FVA being redacted for the purposes of the public consumption. It would be unusual for the entire contents of the FVA to be classified as confidential. Confidential information may be passed to the Council’s consultant to review and advise upon accordingly. (Reference: paragraphs 4.10 to 4.12)

G11  **How should Members be reported to on matters that the applicant considers are confidential?**

These can be outlined by the Council’s consultant in any report without disclosing the confidential nature of the information. It can be mentioned that advice has been sought on this information, in the context of the FVA, from the Council’s consultant. Sometimes information can be reported in aggregate form thereby avoiding individual figures from becoming public. (Reference paragraphs 4.10 to 4.12)

G12  **The applicant and the Council’s consultants have not been able to agree on the FVA. How can this be resolved?**

The guidance recommends that differences of opinion should seek to be resolved. Where disputes are unable to be resolved, the applicant and Council may seek the opinion of a third party. (Reference: paragraphs 4.8, 4.13 and 4.14)
G13 How should the Council’s consultant be briefed on undertaking a due diligence exercise on the applicant’s FVA in the first instance?

During pre-application meetings between the applicant and the Council, it is usual for the scope of the FVA exercise to be identified. This will form both the basis of the FVA and the consultants brief for undertaking the due diligence exercise. (Reference: Section 2)

G14 Should Council Officers be attending meetings between the Council’s consultant and the applicant and their consultant?

This is entirely open to be agreed between the parties as to how to progress matters in the most sensible and appropriate way. It is not usual for both parties’ professional consultants to meet without principals in attendance, for discussing technical matters. (Reference: Section 4)

G15 Is a local authority obliged to let the applicant see a copy of the Council’s consultant’s report before (or after) the Committee to consider the application? Is it sensible for this to be in draft form in the first instance?

It is recommended that applicants are allowed to review the contents of a due diligence report prior to making recommendations to Committee. This allows for errors and matters of fact to be corrected. It may also assist in certain instances in reconciling differences of opinion. If the report is kept in draft, this assists in this process. (Reference: paragraphs 4.6 to 4.9)

G16 Is the sensitivity checking of the results from a FVA important in considering viability in planning terms?

For many, if not most, development proposals which are the subject of planning applications, there remains uncertainty and risk going forward. It is therefore entirely appropriate to test sensitivities within the financial model in order to form an appropriate judgement as to the robustness of the outcome and likely variance. (Reference: Section 2, Appendix B and Appendix C)
G17  Where a “pot” has been identified as to what the scheme can reasonably deliver and remain viable, should the consultant be expected to divide this up (say between affordable housing and other planning obligations) or is that a matter for the Council in negotiation with the applicant?

It is usual for both the applicant’s and Council’s consultant to identify the magnitude of the “pot”. In certain instances, the consultants may also be able to offer advice on division. In other instances, this may be more appropriate for subsequent negotiation between the Council and the applicant (and their advisers). (Reference: Section 2 and Section 4)

G18  Are FVAs only required for affordable housing applications?

No. There are a number of instances where FVAs may be required to assist the planning process. (Reference: paragraph 1.10)

G19  When should applicants be providing FVAs based on growth expectations?

This may occur where there are schemes of long duration or could be in instances where a development may have a regenerative impact which will impact on values which cannot be evidence on a current day basis. (Reference: Paragraphs 3.29 to 3.32)

G20  Are there situations where re-appraisals of viability are appropriate?

As with growth appraisals the same rationale applies. In addition, where growth models cannot be used, it may be more appropriate to review the viability of the application scheme prior to implementation of development. (Reference: Paragraphs 3.27 and 3.28)

G21  Should the Council suggest “overage” or “clawback” clauses in Section 106 Agreements?

No. The guidance sets out why this practice is inappropriate and why re-appraisals prior to implementation are the appropriate way of reviewing the scheme viability in a planning context. (Reference: Paragraph 3.27)
G22 Can the EUV plus or AUV of the land / property input be equivalent to MV (with assumption)?

Yes. In arriving at the Market Value with assumption(s), the practitioner will have regard to the current use of the site (and alternative uses) amongst other matters. In certain circumstances Market Value with the special assumption may equate to the EUV plus or the AUV of the site. It should be noted, however, that EUV cannot be evidenced in the market and the mark up (“plus”) is arbitrary. (Reference: Section 3, Paragraphs 3.18 and 3.19, and Appendix E).

G23 Is there any empirical evidence to support the appropriate return / profit?

There is very little specific evidence. It is often an assumed market benchmark based on common practice. The Independent Property Databank (IPD) have recently produced the first and only study on development returns from 1983 to date. There are alternative approaches to seeking to justify an appropriate return based on the specific risk of a particular scheme. Target rates of return should be contra-cyclical. (Reference: Appendix B and Appendix D)

G24 Should the output from the appraisal be a profit / return or residual land value?

It can be either. Both are measures of viability. (Reference: Section 2 and Section 3).

G25 How important are previous appeal decisions and case law in reviewing FVAs?

The guidance has not sought to reference any appeal decisions or case law. It is recognised that there was a lack of previous guidance in this area for decision makers to rely upon in formulating their views. (Reference: Chair of Working Group Statement)

G26 Are RICS Members bound by the RICS GN in producing a FVA? What about other practitioners?

Members of the RICS are not bound to follow the guidance note. It is up to individual members to decide on the appropriateness in the circumstances. Where a Member does depart from the guidance, they should do so only for good reason. Other practitioners are
not bound to the guidance, but in the absence of relevant alternative guidance, again reasons for departure from this guidance should be set out. (Reference: RICS Guidance Notes).

G27 How does the RICS GN deal with area-wide studies such as producing CIL charging schedules and Local Plan testing?

This is set out in Section 2 of the guidance, at Paragraph 2.10. Practitioners are also directed to the HCA Local Housing Delivery Group guidance which was being drafted at the time of producing this guidance note and the NPPF.

G28 Does the RICS GN prescribe a particular financial model for use with FVAs?

No. This is up to the individual practitioner to adopt as appropriate. In some instances, it may be necessary to set out why a particular financial model is to be used with reasoned justification. (Reference: Section 2, Paragraph 2.19)

G29 How important is the analysis around the inputs into the model and outputs in FVAs?

This guidance note considers this to be fundamental to justifying both the level and variance of inputs but also the sensitivity around the output in formulating a reasoned judgement on viability. (Reference: Section 2, Paragraphs 2.11 to 1.16)

G30 Should all inputs be evidenced or backed up with supporting information?

Yes. In some instances a practitioner’s opinion may be sufficient but in the majority of cases supporting information and evidence is essential. (Reference: Paragraphs 4.3 to 4.5 and Appendix C)
G31  **How do FVAs benchmark the outputs of the financial model?**

This will often have regard to the risk of a particular scheme (and therefore appropriate return) and/or comparable information such as land values. The professional expertise and knowledge of the practitioner, together with their suitability to deal with a particular application scheme are considered important. Benchmarks need to be fully justified and appropriate to the particular circumstances. (Reference: Section 4)

G32  **How important is comparable evidence in arriving at the land / property value?**

It is an important consideration in formulating an appropriate professional judgement of Site Value for the application scheme. Often, it is necessary to analyse and adjust comparable evidence in order to put it in a suitable form to be used for comparison purposes. (Reference: Section 3, Paragraphs 3.16 to 3.19)

G33  **How much does a due diligence report on a FVA cost and who should be paying?**

This depends on the complexity of the exercise. In some cases, the applicant will reimburse the Council for costs incurred in part or as a whole in obtaining a due diligence report on a FVA submitted. (Reference: Section 4)

G34  **Are rights of light payments a legitimate cost?**

Yes. It is appropriate to include, as a development cost, compensation for loss of rights of light to neighbouring properties in respect of the particular scheme being appraised. (Reference: Appendix F)

G35  **Are vacant possession costs (i.e. to compensate tenants, etc.) a legitimate cost?**

Yes. It is a cost incurred by a developer in order to be able to implement a development by agreeing terms to vacate by existing tenants. (Reference: Appendix F)
G36 Should the FVA take account of who the applicant is in terms, for example, of their ability to secure finance, other preferential terms or specific skill attributes?

No. The FVA should disregard who the applicant is, except in exceptional circumstances. (Reference: Paragraph 2.18)

G37 Can the Council engage in a pre-application FVA with an applicant and is the outcome then binding?

The guidance encourages this practice as informing the planning process and reducing uncertainty. The outcome cannot be binding as the Council will determine the application in the normal way. In most cases, the outcome of a FVA (following a due diligence report by the Council’s consultant) will be a material consideration in determining a planning application. (Reference: Section 4)

G38 Can the Council refuse to register an application for an inadequate FVA or if none is provided?

This will depend upon the nature of the planning application and importance of the FVA as a material consideration in determining the application. (Reference: Section 1, Section 2 and Section 3)

G39 Assuming both the applicant’s and Council’s consultants are in agreement, does this mean the applicant and Council are bound by the outcome?

No. Financial viability is only one of the material considerations in determining a planning application. The Council may disagree with their consultant and will need to state why this is the case in any Committee report in making a recommendation. (Reference: Section 4)

G40 Does the RICS GN recognise that in order to grant planning permission, essential planning mitigation must be undertaken notwithstanding financial viability?

Yes. This will usually be set out in an FVA as part of the planning application. (Reference: Section 2)
G41  Will the RICS GN be subject to periodic updates?

Yes. It is intended to be updated as required and necessary.

G42  It has been argued that MV with the assumption is circular in arriving at a land value. Is that correct?

No. It is perfectly possible to formulate a judgement on Site Value using Market Value with the assumption. Chartered Surveyors regularly provide such valuations. (Reference: Section 3 and Appendix E)

G43  How does the RICS GN fit with other policy and previous guidance on viability assessments?

The RICS guidance is a standalone document, setting out best and recommended practice in the context of the UK planning system. It has reference to planning policy which forms the framework for the guidance note. (Reference: Chair of Working Group)

G44  Can FVAs be updated during the planning process?

Viability assessments may occasionally need to be updated due to market movements or changes in the scheme during the planning process. (Reference: Paragraphs 3.20 and 3.21)