8th July 2015
CADV345142

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Dear Mr Kemmann-Lane

REFERENCE - DCS5928/1

ROTHER DISTRICT COUNCIL CIL EXAMINATION - SAVILLS RESPONSE ON BEHALF OF PERSIMMON HOMES PLC TO RDC/4

Further to the Programme Officer's email on the 23rd June 2015, inviting comments on Rother District Council's (RDC) Response (RDC/4), Savills (UK) Limited has been asked by Persimmon Homes PLC to prepare the following formal response.

The purpose of this letter is to set out our response to the document prepared by Peter Brett Associates (PBA) (RDC/4). It is intended to supplement the comments previously submitted to RDC and does not reiterate our representations to the Draft Charging Schedule (DCS) consultation.

The following sections of this letter explain why we consider that further information is needed from RDC and provides additional evidence that we have collected.

Background

1.1 Our client currently controls two sites in Rother. For completeness, we have provided a summary of these sites in Table 1 below, as we will be making specific points in relation to them in the following sections.

Table 1 – Overview of Sites

Site Name	Planning Status	Total Units	Affordable %	CIL Zone
Station Road, Northiam	SHLAA site. Planning application submitted. Decision pending.	66	40	1 – Battle, Rural North & West
Preston Hall Farm, Bexhill (BX3)	Allocated (Policy BX3). Planning application anticipated for October 2015.	c. 130	30	3c – Strategic Urban Extensions

1.2 Persimmon Homes Plc's specific concerns relate to the proposed residential CIL rates, with a particular focus on Zone 1 and Zone 3c.

Response to RDC-4

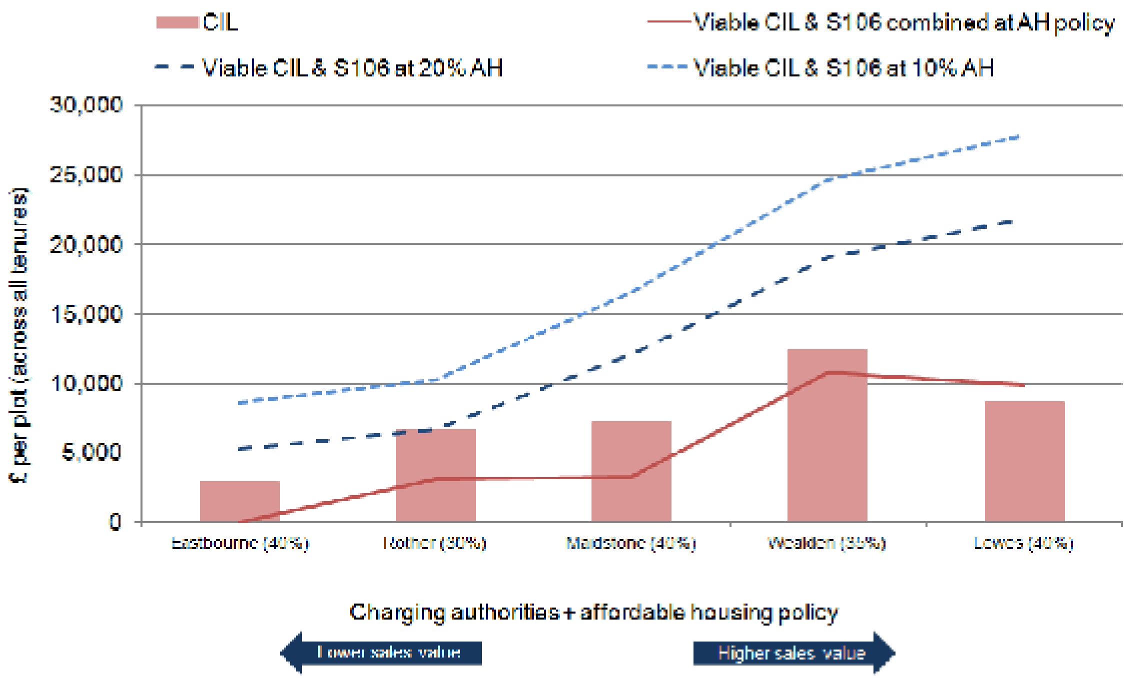
1.3 Responses are given below to the commentary from PBA contained within document RDC/4. We have set out our specific comments in the order that they appeared within the response document. We have only provided responses to those points where we believe further clarification or information is required.

1) Savills Benchmark Model

1.4 We acknowledge the point raised by PBA that the previous graphs included in our DCS representation incorrectly applied an affordable housing provision of 40%. In the graph below, we have subsequently amended our analysis to include the following:

- 30% affordable housing; and
- Sales value of £225 psf.

Graph 1 – Results of Savills Benchmarking Model (assuming 30% affordable housing and £225 psf)



Source: Savills analysis (July 2015)

1.5 We would highlight that this revised analysis does not, as PBA suggest at e), demonstrate sufficient headroom for large greenfield sites in Bexhill. The results in Graph 1 clearly illustrate that even with reduced affordable housing (30%) and increased sales values (£225 psf) the proposed rate of £100 psm (Zone 3c) is above the viable level (i.e. is above the red line).

1.6 The above analysis is based on the Savills 'CIL – Getting it Right' publication[1], which used a residual development appraisal to establish the level of CIL that could be supported on large greenfield sites based on a standard set of assumptions[2] (see Table 2).

Table 2 – Savills Benchmark Model Assumptions

TABLE 5

Assumptions summary

Net Dev Area (% gross area)	50%
Interest rate	6.5%
Marketing (% of sales)	3%
Professional fees (% of build costs)	12%
Additional build cost to 2013 Building Regulations (£ per dwelling)	1,000
Infrastructure (£ per dwelling)	20,000

Density (dwellings per acre)	14.2		
Dwelling size (sq.ft.)	1,030		
Coverage (sq.ft. per net dev acre)	14,600		
Developer profit on all GDV (excluding marketing and finance, to cover overheads)	20%		
Sales value (£ per sq.ft)	300	250	200
Affordable value as % of market value	43%	48%	55%
Build cost (£ per sq.ft)	97	91	86
Land value benchmark inc. buffer (£000 per gross acre)	290	190	95

These are generic assumptions for larger sites with a capacity of more than 500 homes. Local specifics will vary. On smaller sites, costs of infrastructure may be lower but benchmark land values are likely to be higher.

Source: Savills CIL – Getting it Right, January 2014

1.7 We acknowledge that this analysis is based on different assumptions (in particular the inclusion of higher infrastructure/servicing costs); however, we remain concerned that the proposed CIL rates in Zone 3b are too high for the reasons outlined below.

2) Housing Land Supply

1.8 We maintain as per our representation at the DCS stage that there has been an historic undersupply in Rother against the housing requirement and the Council does not dispute this in their response. Indeed, there has been a shortfall of housing delivery which needs addressing through the backlog being included in the housing requirement for the adopted RDC Core Strategy.

1.9 The Council state in their response to the Savills representation that there is no suggestion that recent under delivery is linked to viability. Nevertheless, it is important in the context of CIL that the rate(s) set do not threaten the ability to develop viably the sites and scale of development identified in the Core Strategy.[3]

[1] January 2014
[2] Table 5, Savills CIL – Getting it Right, January 2014
[3] Paragraph 008, Reference ID: 25-008-20140612, Planning Practice Guidance. Revision date 12 June 2014

1.10 Having regard to the Council's response and the housing completion rates achieved in the early part of the Plan period (as identified in Table 2 of our DCS representation), notwithstanding the degree to which delivery has been constrained by road infrastructure provision, it is vital that moving forward through a plan-led system for delivering both the required housing levels and associated infrastructure, that the CIL rates do not threaten the viability on sites needed. Whilst the Council maintain that lower delivery rates were always expected in the early years, such a position would only give rise to greater need to ensure that delivery in subsequent years is not constrained by policy burdens and that the appropriate balance is struck.

1.11 The Council maintain that the proposed rates will not threaten the viability of the range of sites needed. The work on site typologies and assumptions has been based on the Strategic Housing Land Availability Assessment (SHLAA). As referenced in our DCS representation, the Council is working on a Development and Site Allocations Development Plan Document; however, consultation on the initial draft document has now been moved back from July 2015 to Autumn 2015.

1.12 The Council rightly state that the SHLAA is not a policy document and does not determine whether a site should be allocated for housing development across the District. Such decisions will be made through the DPD which takes account of a range of policy and other development considerations. It is therefore difficult to assess whether the viability testing is reflective of the sites likely to come forward and if the proposed CIL rates will have an adverse effect on their viability.

1.13 In addition, the Inspector's Report included a main modification that a review is undertaken of sites in existing employment use and are released for other uses where appropriate.[4] Further to this, the under delivery of housing gives greater significance to the issue that CIL rates do not adversely impact on the viability of development sites in the area.

1.14 In addition, we have highlighted the importance of including a substantial buffer from the maximum CIL rates, to reflect the uncertainty over the sites coming forward and historic under delivery, in order to ensure that CIL is not set at the margins of viability.

3) Duty-to-Cooperate

1.15 For the reasons set out in our representations at the DCS stage, we do not consider that an appropriate balance has been struck between the funding of new infrastructure and economic viability across the District.

1.16 In order to assess the wider impact of CIL and understand whether the rates proposed within Rother are reflective of those generally emerging across the region, we compared the maximum proposed residential CIL rates with a number of adopted and emerging CIL Charging Schedules in neighbouring authorities. A schedule of the rates was provided in Table 3 of our DCS representation. Since our analysis in March 2015, the Eastbourne CIL has been adopted (maximum rate £50 per sq m), as has the Lewes CIL (maximum rate £150 per sq m).

1.17 The rate proposed for the rural areas in Rother is one of the highest rates adopted or emerging for any Charging Schedule in the region. It is exceeded only by the Mid Sussex maximum rate of £235 per sq m which is only proposed at this stage having reached the Preliminary Draft Charging Schedule stage.

[4] Paragraph 50, Rother District Council Local Plan Core Strategy, Inspector's Report July 2014.

As stated in our representation, the sales values in Mid Sussex, as with the majority of authorities in the region (and consequently the average sales value), are higher than in Rother District.

1.18 The Council's response in section 3.3 of RDC-4 refers to the Wealden comparison being most comparable. It should be noted however that lower sales values have been applied in Rother compared with Wealden. The conclusion we draw from this, albeit very broad brush comparison, is that the rates proposed for Rother are very high in comparison with others in the South East. The proposed maximum CIL rates in Rother are indeed higher than those proposed in other Charging Schedules despite lower average sales values. This reinforces the concerns we have regarding the robustness of the viability evidence.

4) Benchmark Land Values

1.19 We welcome confirmation from PBA that the BLVs reported in the Viability Study are based on net developable land areas. Unfortunately our client is unable to provide any further evidence of land transactions in the area.

5) Large Strategic Site Typology Assumptions

1.20 We do not accept the point put forward by PBA that the allowance included in the Viability Study for infrastructure and servicing costs (on the larger typologies) is sufficient. Even including the externals allowance of £7,511 per dwelling[5], as suggested by PBA, indicates a total allowance of £13,921 per dwelling. This is significantly below the minimum cost indicated by Harman, which has been adopted in a number of recent viability assessments as an appropriate assumption. We would therefore argue that a minimum allowance of £17,000 per dwelling be adopted for the larger typologies.

1.21 In addition, we would highlight that the PBA typologies do not include any allowance for abnormals. Whilst we acknowledge that this will vary substantially from site to site, the inclusion of a lower infrastructure allowance generally across the typologies means that there is less headroom for these variances within the viability testing. We would therefore advocate that a higher total allowance for servicing and infrastructure is included.

7) Build Costs

1.22 PBA correctly highlights in their response[6] the need to consider both build cost inflation and house price growth for an area. We do not dispute that there has been an increase in sales values across the District since 2013. However, having reviewed the sales value evidence adopted by PBA[7] we do not believe that appropriate figures have been adopted for some of the rural areas.

1.23 For example, we have looked at recent sales evidence in the area around Northiam (Zone 1), which is assumed in the PBA work to be as follows:

[5] RDC/4, paragraph 5.3
[6] RDC-4, paragraphs 7.1-7.3
[7] Ibid, paragraphs 4.2.21 – 4.2.28

Table 3 – Northiam Sales Value Assumption

	Sales Value (£psm)	Sales Value (£psf)
Houses	£3,404	£316
Flats	£2,654	£247

Source: PBA Viability Study[8]

1.24 There is a dearth of recent new build comparable evidence in the rural areas. However, our client has commissioned a sales report for the Northiam area detailing recent sales in the immediate area. A summary of the sales evidence collected is provided in Table 4:

Table 4 – Northiam Sales Value Assumption

Address	Date of Sale	Price Achieved	Sq Ft	£psf
15 Farleys Way, Peasmarsh	Jul-15 (Exc.)	£184,950	632	£293
Cripps Cottage, Cripps Corner	Nov-14	£197,000	644	£306
5 Pond Close, Broad Oak	May-15 (STC)	£200,000	801	£250
58 New Moorsite, Westfield	May-14	£175,000	839	£209
The Willows, Northiam	Jun-15	£227,000	909	£250
5 Farm Gardens, Peasmarsh	Jun-15	£239,950	1007	£238
52 Oakhill Drive, Broad Oak	May-15 (STC)	£185,000	1011	£183
6 Monks Way, Northiam	Dec-14	£267,000	1029	£259
Dewmory, Northiam	Jan-14	£235,000	1034	£227
21 Maytham Road, Rolvenden	Sep-14	£249,000	1043	£239
8 The Martlets, Broad Oak	Apr-14	£228,000	1052	£217
1 Oakfield Cottages, Brede	Jul-14	£290,000	1131	£256
1 Copthall, Newenden	Dec-14	£249,950	1213	£206
1 Hollow Cottages, Northiam *	Jun-15	£365,000	1219	£299
Alpha Place, Broad Oak	Aug-14	£372,000	1591	£234
Plot 1 Mons Calpe, Broad Oak *	Mar-14	£399,950	1867	£214
7 Willowbank, Robertsbridge	Sep-14	£425,000	2024	£210
Plot 2 Mons Calpe, Broad Oak *	Apr-14	£440,000	2169	£203
Average				**£232**

*Source: Douglas Moloney & Partners report (NB: * denotes a new build property)*

1.25 This evidence indicates that an average figure of £2,497 psm (£232 psf) should be applied to resale stock in Northiam and the surrounding area. Increasing these values by 20% to reflect a new build premium and smaller units indicates that an average sales value of £2,996 psm (£278 psf) should be applied. This reflects 12% less than the figures adopted by PBA in the viability testing.

1.26 Even taking into account the 5% growth that PBA believe has occurred in Rother since 2013[9], this indicates that lower sales values should have been tested in relation to this area of the District. As PBA

[8] Ibid, paragraph 4.2.28

highlight *"This growth in values is similar to the increase in build costs, and in viability terms, would have a much greater positive impact on the bottom line viability figure.'*[10] The opposite is therefore also true. If the sales values adopted by PBA are incorrect, and lower figures should be applied, then this will have a significant impact on the bottom line viability figure.

1.27 This is concerning as the justification for the higher CIL rate proposed in the rural areas (Zone 1 and 2) is based on higher sales values in these areas. We would therefore recommend that additional sales value research is undertaken to ensure that appropriate sales values are adopted. In any event, we would ask that the testing for the Northiam area is re-run to include the lower sales value evidence that we have provided.

8) Developer's Profit

1.28 Please find enclosed a report[11] providing further information in support of our comments in respect of developer's profit on larger residential sites. This counters the assertion from PBA that market conditions have improved, resulting in reduced risk for developers.

9) Section 106 Costs

1.29 We acknowledge that at this point in time it is difficult to estimate the residual Section 106 obligations that will be required on sites of varying scale across the District. However, we do not believe that the response from PBA[12] fully addresses the point raised in our DCS representation[13].

1.30 The Regulation 123 List as currently drafted expressly requires '*on-site infrastructure and improvements*' under Transport to be excluded from CIL. Whilst we acknowledge that certain elements of this would fall within wider site opening-up and servicing costs, the following items would typically be delivered via Section 106 and 278 agreements:

- Measures to facilitate pedestrian, public transport and cyclist improvement and access;
- Mitigation works remote from the development where the need for such works is identified in a Transport Assessment; and
- A269/Holliers Hill/A2036 Wrestwood Road/London Road.

1.31 Similarly under the other sections in the draft Regulation 123 List, sites will continue to be required to deliver items '*necessary to make the development acceptable in planning terms'* (i.e. open space, community facilities, healthcare and flood mitigation). Clearly the level of on-site requirements will vary depending on the scale of development; however, the current wording of the Regulation 123 List implies that all development sites will have an on-site requirement, which raises the potential for 'double-dipping'.

<u>Combined Impact of CIL & Section 106</u>

1.32 In light of this, and our comments at Section 7 above, our client is concerned that the Council has over-estimated the capacity of small rural sites to support the proposed CIL Rates. This is particularly

[9] RDC-4, paragraph 7.2
[10] Ibid
[11] Developer Profit – Competitive Return to a Willing Developer, October 2014
[12] Ibid, paragraph 9.4
[13] Paragraph 1.50

relevant for Zone 1 – Battle, Rural North and West where the highest CIL Rate is being proposed (£200 psm), which includes our client's site at Northiam.

1.33 To illustrate our concern, we have undertaken an exercise to establish the potential CIL liability based on the emerging CIL rate for Zone 1. In doing this, we have taken the current masterplan and schedule of accommodation for the scheme and calculated the total private floor area. This can be summarised as follows:

Table 5 – Northiam Private Schedule of Accommodation

Type	Number	Sq Ft	Sq M	Total (Sq Ft)	Total (Sq M)
2B House	5	631	59	3155	293
3B House	6	761	71	4566	424
3B House	10	969	90	9690	900
3B House	4	999	93	3996	371
4B House	9	1222	114	10998	1022
5B House	2	1414	131	2828	263
5B House	3	1574	146	4722	439
4B Chalet	1	1600	149	1600	149
Plus 10% allowance for garages				4156	386
TOTAL	**40**			**45711**	**4247**

Source: Persimmon Homes Plc

1.34 From this, we were then able to estimate the CIL liability for the scheme assuming the Zone 1 residential CIL rate of £200 psm. The results of this analysis are as follows:

Table 6 – Northiam CIL Liability Estimate

Total Private Floor Space (Sq M)	CIL Rate (£psm)	CIL Liability	Section 106 @ £1k per unit	Total CIL & Section 106	£ per unit
4,247	£200	£849,330	£66,000	£915,330	£13,869

Source: Savills analysis (July 2015)

1.35 The above analysis shows that the proposed CIL rate and residual allowance for Section 106 (£1k per unit) is in excess of £13,000 per dwelling. In our experience, this is significantly higher than historically agreed Section 106 agreements on sites on this scale across the District. This is particularly concerning as the work undertaken by PBA[14] indicates that 43% of planned development will occur in Zones 1 & 2.

[14] Viability Study, Table 4.7

1.36 It is therefore essential that the proposed CIL rates do not prevent sites from coming forward, as rates set too high risk reductions in affordable housing being sought in order to maintain viability, particularly in light of our comments above in respect of sales values in the rural areas.

1.37 We therefore believe that it is imperative that the Council reviews their figures and assumptions in respect of residual Section 106 contributions (post-CIL) to ensure that future CIL liabilities are not in excess of the total ‘pot’ previously delivered on sites; as failure to do so poses a substantial risk to the housing supply.

10) Calculation of Proposed CIL Rates

1.38 We welcome the further information in respect of the calculation of the CIL rates from PBA, which demonstrates that a viability buffer has been applied to all zones. However this only indicates the average headroom for each Zone, rather than looking at the range of results for the various typologies.

1.39 We would highlight that we have not been provided with copies of the PBA appraisals, so cannot confirm whether these maximum headroom figures are correct. We have therefore been unable to produce alternative appraisals looking at the impact of changing the assumptions highlighted above (in particular the sales values) on the capacity for sites to support the proposed CIL rates.

1.40 We would therefore ask that the full appraisals be made available ahead of the Examination and that parties be given the opportunity to comment on them.

15) Application of Differential Rates

1.41 We note that MOD 12 amends the residential CIL zones map and accompanying Key. However, we would highlight that having reviewed the DCS that the proposed Bexhill Inset – Zone 3 map remains complex and could be made more user-friendly. Under MOD 13, the Council has added the following wording to the Bexhill Inset – Zone 3 map:

Zone 3

a) Bexhill - Urban

b) Bexhill - Greenfield

c) Bexhill – Strategic urban extensions

Within Bexhill, the zones are defined as:

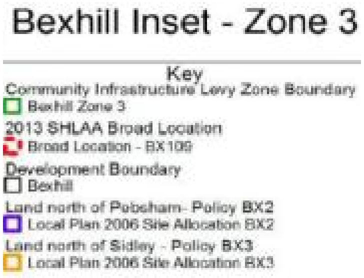
3a – non-greenfield sites within the extant ‘development boundary’ for the town

3b – all other sites in and around the town, except as covered by 3c below

3c – developments within (or mainly within) either the allocated sites BX2 and BX3 in the Local Plan 2006 or within the broad location for future growth to the north of the town, as identified in the SHLAA 2013

Source: RDC-7

1.42 The key for the map then outlines the various boundaries.



Source: RDC-7

1.43 This appears to be an overly complex zoning structure for Bexhill area and creates potential for confusion, as a number of the sub-zones and boundaries overlap with one another. We would subsequently recommend that the 'development boundary' be amended to exclude those areas covered by zone 3c and that this zone is colour coded for ease of reference.

Summary

Having reviewed the additional evidence provided by the Council and PBA (RDC/4) we do not believe that the concerns raised in our DCS representation have been fully addressed. We would therefore ask that the following:

- Additional viability work is undertaken, incorporating the figures set out above, and that these appraisals are made available for scrutiny by interested parties;
- That the sales values adopted for the rural areas are reviewed; and
- The Council's position on Section 106 post-CIL on all scales of development is clarified so that the total impact of CIL and Section 106 can be considered.

Yours sincerely
For and on behalf of Savills (UK) Ltd

Lizzie Cullum MA (Cantab) MRICS
Associate

Encs. Developer's Profit – Competitive Return to a Willing Developer (Savills, October 2014)

October 2014

Developer Profit

Competitive Return to a Willing Developer

savills.co.uk

Introduction

1.2 Savills is representing HBF members and other house builders and landowners nationwide on emerging CIL Charging Schedules, to scrutinise the available evidence, notably in respect of infrastructure provision and the testing of viability against both the emerging planning policy requirements and the identified housing land supply. We are therefore well placed to observe trends in the emerging viability work and subsequent CIL examinations.

1.3 The purpose of this Briefing Note is to present the evidence of what represents a competitive return to a willing developer.

Developer's Profit

2.1 The NPPF states that to ensure viability developments should provide competitive returns to a willing land owner and willing developer[1]. A competitive return to a developer is one that provides a sufficient return for the developer to continue a successful business through the economic cycle, taking account of the risk profile of the business. The most readily available market evidence of a competitive return is the return required by the shareholders of the quoted Plc housebuilders, noting that the Top 10 House Builders accounted for 45% of completions in England 2012/13[2].

2.2 Shareholders are principally institutional investors - pension funds, insurance companies and private equity funds. They have a wide range of companies and sectors to choose from, including retail, housebuilding, mining, transport, energy and telecommunications, all with different risk and return profiles. If shareholders' hurdle rates are not achieved then they will invest in other sectors, reducing the development capacity of the housebuilding sector.

2.3 The key measures are Operating Margin and Return on Capital Employed (ROCE). For a development to be viable, both measures need to meet acceptable target levels. ROCE and Internal Rate of Return (IRR) are closely related; IRR is the projected compound annual rate of return on capital employed across the life of the scheme, compared with ROCE which is the return on capital employed in any one year.

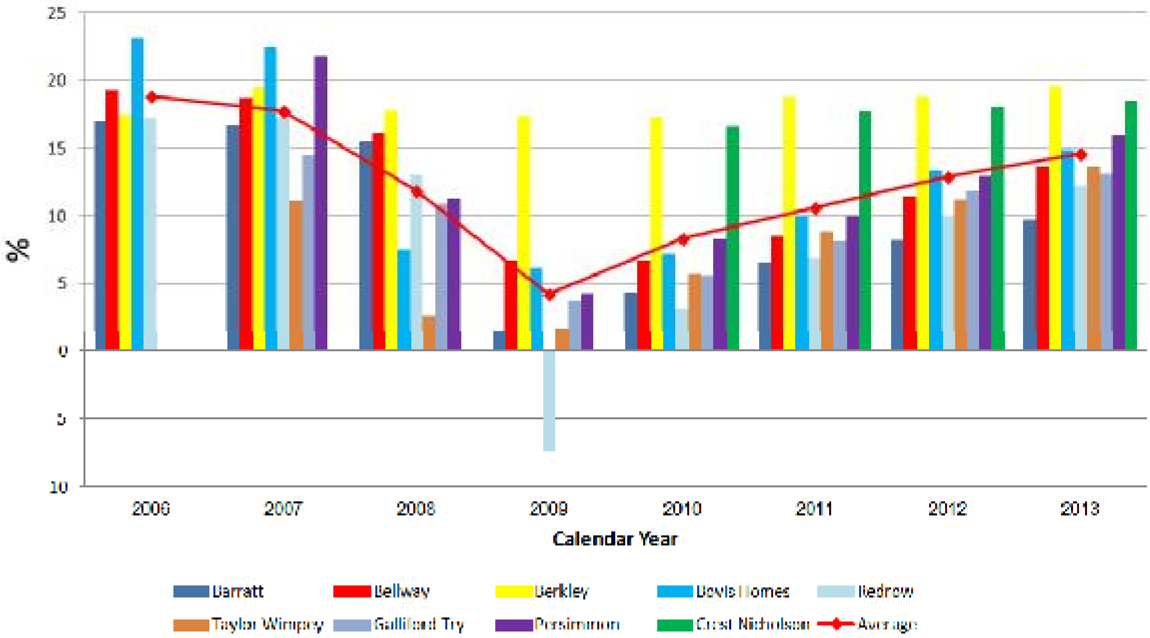
2.4 The operating margins (based on Earnings or Profit before Interest and Tax) of the Plc housebuilders are shown in Figure 1. The average margin has recovered from a low of 4.3% in 2009 to 14.6% in 2013. Within this, Berkeley has maintained a margin of between 15% and 20% throughout the cycle, as has Crest Nicholson since 2010. All other housebuilders are rebuilding margins towards that level. As examples:

- in August 2013 Persimmon stated that it had reached its target margin of 15-17% of revenue, 18 months ahead of plan; and
- in July 2014 Taylor Wimpey announced targets for the 2015-17 period of an average 20% operating margin and a return on net operating assets of 20% per annum.

2.5 **It is important to distinguish between gross (site level) margin and the net operating margin reported in house builder accounts**. This is discussed in the Harman Report, which suggests that "*Overheads for house-building typically lie in the range of **5% - 10% of gross development value**, with only the very largest developers operating near the lower end of the scale*"[3].

[1] NPPF, Communities and Local Government. Para 173. March 2012
[2] Facts & Statistics, House Building Statistics, HBF, August 2014
[3] Viability Testing Local Plans, Chaired by Sir John Harman, June 2012

Figure 1 - Net Operating Margins 2006 - 2013



Source: Savills

2.6 JP Morgan analysis[4] of Plc housebuilder performance for the financial years 2012 and 2013 indicates that the average overheads of housebuilders (the difference between Gross Margin and Earnings Before Interest and Tax) were 6.4% and 6.0% of revenue respectively, averaging 6.2%.

2.7 Therefore a target operating margin of 15% to 20% of revenue equates to a target gross margin of 21% to 26% of gross development value. Barratt stated in its 2012 annual report (and in its July 2014 trading update) that its minimum hurdle rates for land acquisition are 20% gross margin and 25% ROCE.

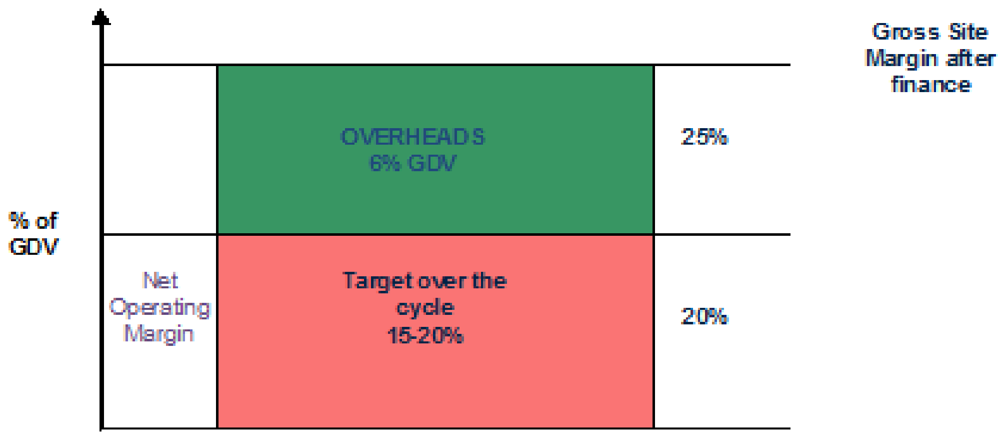
2.8 Both operating margin and gross margin are quoted before deduction of the cost of paying interest on debt, which has averaged 1.2% of GDV over the 2013 and 2013 financial years. Therefore the hurdle rate of gross margin after deduction of the cost of debt is 20-25% of gross development value.

[4] UK Housebuilding, Europe Equity Research. J.P. Morgan. September 2013

2.9 This is the basis of the developer margin hurdle rate that is applicable to site level development appraisals of Residual Land Value, in which the cost of debt is included separately as a cost. More specifically, this is the average hurdle rate across all sites developed by the housebuilder during any one year. Around this average, there will be a range of site specific development risk and therefore a range of site level hurdle rates for developer margin. Smaller lower density sites are inherently less capital intensive and less risky than costlier larger sites and higher density sites, so for smaller lower density sites the hurdle rate will be below the corporate average and for larger complex sites and higher density sites it will be above the corporate level average.

2.10 This is particularly relevant for large Greenfield sites and regeneration areas, where large up-front costs have an impact on a developer's required Return on Capital Employed (ROCE), as a higher margin is required to reflect the higher risk. In these instances, the profit margin and ROCE become much more important as highlighted by the Harman Report – *"Developments of large flatted blocks on previously used land in urban areas with high cash requirements will demand significantly higher levels of profit to achieve an acceptable ROCE than developments of a more standard, less cash intensive nature on virgin ground. Likewise, projects with significant up-front infrastructure may also require higher levels of profit to generate an acceptable ROCE."*[5]

Figure 2 - Developer's Profit Breakdown



Source: Savills

2.11 A minimum developer margin of 20% of Gross Development Value was supported by the appeal decisions relating to The Manor, Shinfield[6] and Lydney[7]. It has also been included in Maldon District Council's supporting viability work produced by HDH Planning & Development who are currently preparing supporting viability evidence for 24 Local Authorities[8].

[5] Viability Testing Local Plans, p46, Chaired by Sir John Harman, June 2012
[6] Ref: APP/X0360/A/12/2179141, 8 January 2013
[7] Ref: APP/P165/Q/14/2215840, 3 September 2014
[8] Local Plan & CIL Viability Study – Post Consultation Update (November 2013)

2.12 The evidence in this paper indicates that the **minimum profit level** used within viability testing should be a blended rate of **20% on Gross Development Value plus 25% ROCE across all tenures, subject to consideration of the risk profile of the scheme**. The reference to ROCE is particularly important on large capital intensive schemes. In these cases the relevant hurdle rate for site specific appraisal is an **Internal Rate of Return of at least 25%.**

2.13 A number of viability consultants argue that a different profit level should be applied to private and affordable housing. If this is the case, then the blended margin across all tenure should equate to the hurdle rate referred to above. As an indication, a developer's blended profit margin on site of 20% of Gross Development Value could be a combination of Affordable Housing at an 8% margin on cost and Market Housing at a 23% margin on Gross Development Value.

2.14 It is increasingly common for developers to purchase land prior to securing an offer from Registered Providers who are subject to more market risk from the current affordable housing regime than in previous systems of funding. There is subsequently a risk associated with the affordable housing, in addition to increased holding and finance costs.