

# Slipping through the loophole

How viability  
assessments are  
reducing affordable  
housing supply in  
England

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Rose Grayston

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# CHAPTER 1: EXECUTIVE SUMMARY

## What is happening to affordable housing supply in England?

**In England, we aren't building enough homes – and particularly enough affordable homes for people who cannot afford to rent or buy at market prices. The reasons for this undersupply of affordable homes go back decades, including reductions in capital grant and financial restrictions placed on local authorities. But since 2012, national planning rules have made the problem worse by enabling the widespread use and abuse of viability assessments.**

These are appraisals of the amount of profit a developer can expect to make on a scheme. If expected profits are below 20%, the number of affordable homes the developer is required to build under Section 106 agreements can be knocked down. The same is true for transport and infrastructure, quality design, the sizes of new homes – or anything else the local community might have expected from the development. They all get squeezed by viability assessments.

This provides a safety net for developers, who can overpay for land to guarantee they win sites, safe in the knowledge they will be able to argue down community benefits to make their money back later. The current system rewards developers who overpay for land and works against those who try to pay the right price for land to deliver affordable housing policies. As a result, land prices have shot up while communities have lost out on thousands of affordable homes every year since 2012.

**Fortunately, there is a simple solution to this problem: closing the viability loophole in national planning rules. When the government amends its National Planning Policy Framework in early 2018, it should follow through on plans in the current [Planning for the right homes in the right places](#) consultation to limit the use of site-level viability assessments to exceptional circumstances, in which case they will be fully transparent and available for public scrutiny.**

When developers have certainty about the number of affordable homes to build, this will be part of the normal cost of doing business. They will no longer need to overpay for land to stay competitive in the first place. Developers playing by these new rules will still be able to make good returns, while providing their share of the affordable homes the country desperately needs.

By shutting down the viability loophole, the government can drive up the delivery of affordable housing, increase overall housing supply and speed up build-out rates. This does not require additional public money, which can instead be invested in expanding supply elsewhere and lowering rents to genuinely

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affordable levels. In this way, the government can make sure communities get more of what they want from new housing schemes, increasing local support for housebuilding.

### **How Section 106 provides affordable homes**

Currently, we rely on private developers to deliver a large proportion of new affordable homes through the Section 106 system. Also known as ‘planning obligations’, Section 106 agreements have been a feature of the planning system since the 1990 Town and Country Planning Act. As a condition of gaining planning permission to build homes for sale or private rent, developers can be required by the council to also build a proportion of affordable housing to meet the needs of households who will not be able to afford the new private housing.

The proportion of affordable homes required in each location should be set out in the Local Plan, but the precise number for each individual scheme is negotiated separately, resulting in a Section 106 agreement. In effect, some of the profit made from developing homes for private sale is channelled into subsidising new affordable homes. In economic terms, however, the cost should fall on the landowner, not the developer, who should factor the cost of affordable housing required into the prices they pay for land.

Between 2012–13 and 2015–16, Section 106 delivered 38% of the new affordable homes built in England; providing an average of 17,000 additional affordable homes each year. But while Section 106 continues to make an important contribution to affordable housing delivery, this system is not delivering the numbers of affordable homes that it should – and could.

Between 2007–08 and 2011–12, even as the housing market suffered its worst downturn in a generation, Section 106 delivered an average 27,000 homes a year – amounting to 52% of all new affordable homes. This is 10,000 more affordable homes per year than has been achieved in the much more buoyant market of recent years.<sup>1</sup>

The cause of this shift can be found in changes to the planning system introduced in 2012. A few ambiguous phrases in the National Planning Policy Framework and the National Planning Practice Guidance have led to the growth of an industry of viability assessments, used by developers to reduce numbers of affordable homes in order to offer higher bids for land up-front and guarantee high returns for themselves.

### **The viability loophole**

Viability assessments are financial appraisals carried out on planned housing developments. They estimate the amount the developer will spend building the homes, and the profit they will make from selling them. If this profit level is too low, the scheme can be said to be ‘non-viable’ – in which case the development

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<sup>1</sup> Brownhill, S and Cho, Y, *Rethinking planning obligations: balancing housing numbers and affordability: The update*, Oxford Brookes University, 2017 p.6

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may not proceed at all. The local authority may therefore decide to reduce the amount of affordable housing it demands, and/or other contributions towards local infrastructure, in order to raise the developer's profit to a viable level.

What is considered a viable level of profit is therefore critical. Since 2012, the National Planning Policy Framework has defined viability as 'competitive returns', which the industry and the planning system interpret to mean at least a 20% profit margin.

This is the viability loophole. Developers can cite viability concerns to lower the amount of affordable housing they are required to provide, in order to guarantee them a 20% profit margin and inflate their bids for land.

The viability loophole doesn't only impact on development schemes that run into trouble – it undermines affordable housing provision right across the board. Developers know that they can use the loophole, and so factor it into their bids for new sites. In fact, they must: if one developer does not plan to use the loophole, they risk being outbid for land by another one who does. This pushes the price of land up, making development more expensive.

As the land price takes up more of the value of the development, and the developer's profit is effectively guaranteed by the viability loophole, there is less value left to support community benefits like infrastructure and affordable homes. So, the existence of the viability loophole permanently reduces the amount of affordable housing that the system can provide.

The role of viability assessments in pushing down affordable housing delivery is well known throughout the planning and housebuilding industries. However, the scale and geographical spread of the problem has remained largely hidden until now, because viability assessments themselves are usually confidential documents. What information is available is fragmented and difficult to find.

## New evidence on the impact of viability

To address this evidence gap, Shelter has undertaken research across 11 local authorities, covering nine of England's biggest cities, to reveal the impact of viability assessments in urban areas across the country.

The research assessed all planning permissions approved in the year 2015–16,<sup>2</sup> and covers Newcastle upon Tyne, Manchester, Leeds, Leicester, Birmingham, Oxford, Cambridge, Bristol, and three London councils: Brent, Southwark, and Kensington and Chelsea. The findings reveal clear trends.

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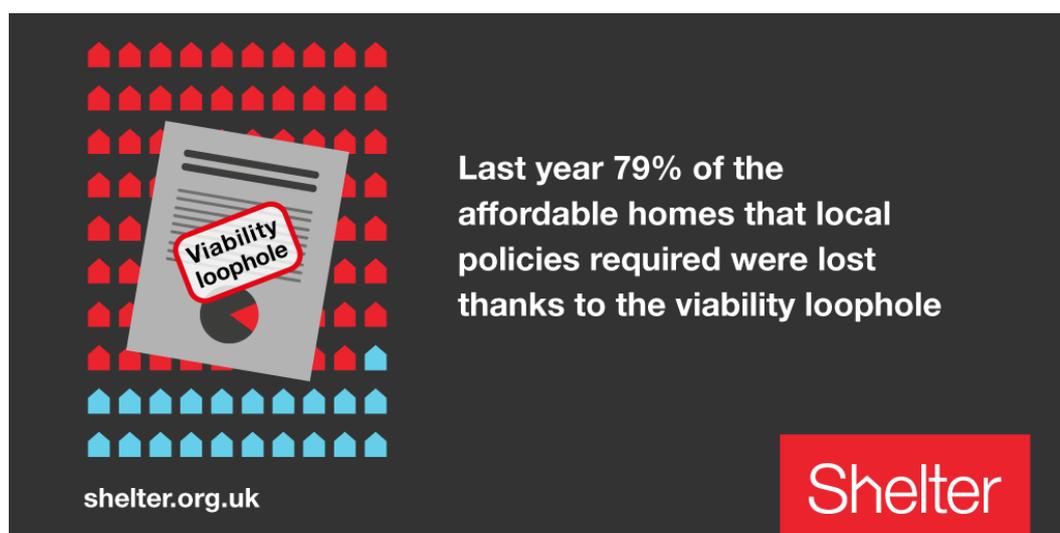
<sup>2</sup> Only schemes which would normally be required to have affordable housing are included in this research. National policy has removed affordable housing requirements from schemes under 10 homes since November 2014. Some local authorities have additional exemption policies. For example, Birmingham does not require affordable housing on schemes under 15 homes.

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## Developers have successfully slashed affordable housing numbers using viability assessments

Where viability assessments were used, new housing sites achieved just 7% affordable housing. This is far below the affordable housing policies of the local authorities in this study, which vary by area but on average require that 28% of new homes built should be affordable homes.

This amounts to 2,500 affordable homes lost in just one year on schemes where developers submitted viability assessments, equivalent to a 79% reduction in affordable housing compared to the levels required by council policies. This is happening in some of the country's least affordable areas, where these homes are most needed.



## Viability assessments have become normalised in the planning system

Viability assessments were used to negotiate down affordable housing provision on almost half (44%) of new developments in the study, rising as high as 77% in Kensington and Chelsea.

## Developers of large schemes are far more likely to argue down affordable housing numbers

Viability is used much more often on large housing schemes than on smaller sites. The average number of homes on sites where viability was used was 130, compared to an average of 73 on schemes with no viability assessment. This has implications for competitiveness and the overall efficiency of the housebuilding sector – skewing opportunities in favour of big developers building big sites, with those building smaller schemes more likely to play by the rules and lose out financially.

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## **We are missing out on affordable homes all over the country because of viability assessments**

So far, there has been more research into the role of viability assessments in reducing affordable housing numbers in London than elsewhere.<sup>3</sup> But this study reveals drastic reductions in cities all over England. In just one year, sites where developers submitted viability assessments saw:

- 1,003 affordable homes lost in Birmingham
- 472 affordable homes lost in Manchester
- 338 affordable homes lost in Leeds
- 196 affordable homes lost in Bristol

## **The use and impact of viability varies considerably by area**

While the viability loophole is not restricted to any one part of the country, the local authorities in this study show considerable variation in how often viability assessments are used and how many affordable homes new housing schemes lose as a result.

This partly reflects differences in local housing markets and partly results from differences in local policies and practice. Some councils, like Cambridge, have developed effective strategies for limiting the use of viability assessments, helped by strong demand from developers to build there. Others, like Manchester, give developers clear grounds for making viability claims in their own local planning policies and guidance. In all cases, national planning rules act as hurdle to overcome in getting affordable housing built.

Full results by local authority are given in Chapter 3 of this report.

## **Benefits of reform**

In addition to driving up the supply of desperately needed affordable homes, closing the viability loophole would also bring broader benefits for the housing market, speeding up build-out rates and driving up overall supply.

The decision to relax planning obligations through viability was taken to boost sluggish markets for land and housing following the last recession, with the aim of getting more homes built overall. In fact, as the Chartered Institute of Housing and others have pointed out, the use and abuse of viability assessments is now holding back overall housing supply by exacerbating an over-reliance on a small number of developers and a lack of diversity in housing output.

A strictly limited, fair and transparent system of viability assessments would:

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<sup>3</sup> See, for example, Sayce, S, Crosby, N, Garside, P, Harris, R and Parsa, A, *Viability and the planning system: The relationship between economic viability testing, land values and affordable housing in London*, Royal Agricultural University, 2017

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- Improve efficiency and competition in the housebuilding sector by creating a level playing field between developers of larger sites, who are much more likely to use viability assessments, and developers of smaller sites.
  - Increase the range of housing built, so that the natural limits to demand for market housing for sale do not unduly constrain build-out rates. Lichfields analysis shows that large sites delivering 30%+ affordable housing have build-out rates 40% higher than those of large sites delivering only 10-19% affordable housing.<sup>4</sup>
  - Remove the need for costly and lengthy negotiations around affordable housing numbers, speeding up the rate at which planning permissions can be built out.
  - Increase local support for new housebuilding by getting more of what existing communities want from developments.

## Recommendations

**Recommendation 1:** Strengthen Local Plans so that commitments around affordable housing and other community benefits are understood as policies, not as targets.

**Recommendation 2:** Limit the use of site-level viability assessments to exceptional, unforeseeable circumstances outside the scope of normal market risk, with eligible circumstances defined by central government and accompanied by guidance on plugging viability gaps using subsidy and other means.

**Recommendation 3:** Building on the Mayor of London's supplementary planning guidance on viability,<sup>5</sup> incentivise policy-compliant schemes with a 'speedy boarding' fast-track option through the planning system. Disincentivise non-compliant schemes through review, clawback and overage mechanisms, so that when sales values exceed those anticipated at the time of the site-level viability agreement, the greater Gross Development Value is used to restore community benefits.

**Recommendation 4:** Redefine and clearly justify the level of returns to be supported by the planning system, removing the phrase 'competitive returns' from the National Planning Policy Framework.

**Recommendation 5:** Where site-level viability assessments are used, make all evidence used in negotiations fully transparent, public and available online in a standardised, accessible format. Viability evidence used in Planning Inspectorate appeals must be subject to rules of expert evidence.

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<sup>4</sup> Nathaniel Lichfield & Partners, *Start to finish: how quickly do large-scale housing sites deliver?*, 2016, p.3

<sup>5</sup> Mayor of London, *Homes for Londoners: affordable housing and viability supplementary planning guidance 2017*, 2017

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## Report structure

Chapter 2 of this report explains how the use of viability assessments leads to the undersupply of affordable housing and reduces the resources available for improving local transport, infrastructure and services.

Chapter 3 outlines the results of Shelter's new research into the role of viability assessments in 11 local authorities across nine English cities, providing powerful new evidence of the scale and geographical spread of affordable housing shortfalls resulting from the viability loophole.

Chapter 4 argues that shutting down this loophole would produce broader benefits for overall housing supply. A strictly limited, fair and transparent system of viability assessments can play an important role in fixing the country's broken housing market, improving efficiency and competition in the housebuilding sector, speeding up the rate at which new homes are built and boosting public support for new developments.

Chapter 5 gives Shelter's recommendations for the changes we need to see to the National Planning Policy Framework to shut down the viability loophole, limiting the use of site-level viability assessments to exceptional circumstances, in which case they must be standardised, publicly available and unredacted. These changes are in line with government recommendations in the current [Planning for the right homes in the right places](#) consultation, due to close on 9 November. It also considers proposals to replace the provision of affordable housing through Section 106 with financial payments through the commuted sum system, and gives Shelter's reasons for opposing this.

Chapter 6 concludes the report.

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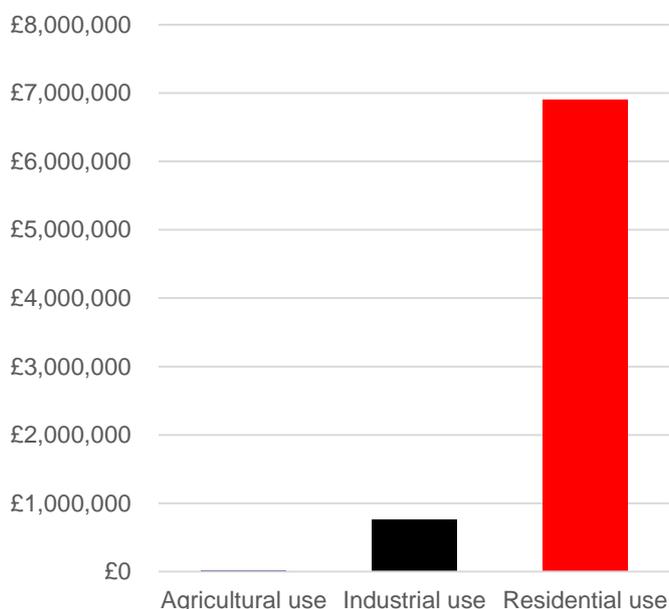
# CHAPTER 2: THE PROBLEM – HOW VIABILITY REDUCES AFFORDABLE HOUSING AND INFLATES LAND VALUES

Governments of all stripes have consistently delivered far less affordable housing than the 75,000 a year needed.<sup>6</sup> Meanwhile, the need for affordable housing has grown ever more urgent, with 121,000 children now growing up in temporary accommodation.<sup>7</sup> This long-term failure is partly due to reductions in the amount of public grant available and financial restrictions placed on local authorities.<sup>8</sup>

But this is only part of the picture. A significant proportion of new affordable housing supply is provided as part of for-profit housing developments, through Section 106 agreements between councils and developers. How well the Section 106 system is working is therefore critical to overall affordable housing supply.

## How is affordable housing provided through private development?

**Land value by planning status, per hectare**<sup>9</sup>



When councils grant planning permission for residential development on a piece of land, its value shoots up by hundreds of times at the stroke of a pen.

The chart to the left shows values for an equivalent hectare of land in England under three uses: agricultural, industrial and residential.

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<sup>6</sup> Holmans, A, *Housing need and effective demand in England: A look at "the big picture"*, 2014, p.10

<sup>7</sup> DCLG, Detailed local authority level homelessness figures: April to June 2017

<sup>8</sup> Since 2010/11, the number of affordable homes built with government money has more than halved – from 55,909 to 27,792. DCLG, Table 1012, 2017

<sup>9</sup> DCLG, *Land value estimates for policy appraisal*, 2015

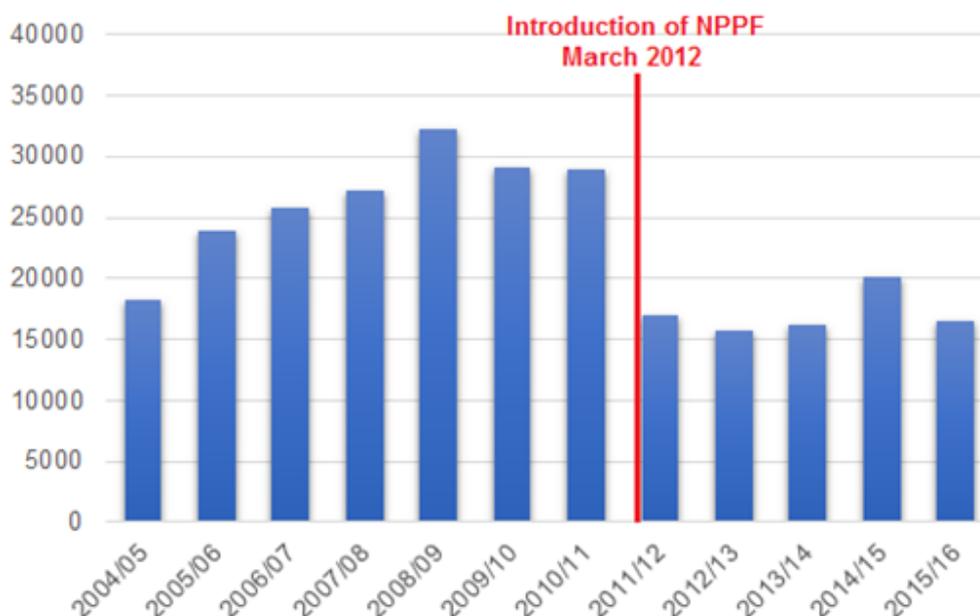
This 'planning gain' provides the landowner with a profit from selling the land, the developer with a profit from building homes, and the community with benefits such as affordable housing, transport and funding to expand education and health services. Section 106 agreements are the mechanism councils use to secure these community benefits. Without them, an area can struggle to cope with its growing population, and the existing community is less likely to support new housing.<sup>10</sup>

As a condition of gaining planning permission to build homes for sale or private rent, developers can be required by the planning authority to also build a proportion of affordable housing to meet the needs of households who will not be able to afford the new private housing. The proportion of affordable homes required should be set out in the council's Local Plan, but the precise number for each individual scheme is negotiated separately, resulting in a Section 106 agreement between the developer and the authority.

In effect, some of the profit made from developing homes for private sale is channelled into subsidising new affordable homes. In economic terms, however, the cost should fall on the landowner, not the developer, who should factor the cost of providing the affordable housing required into the prices they pay for land.

Between 2012–13 and 2015–16, Section 106 delivered 38% of the new affordable homes built in England, providing an average of 17,000 additional affordable homes each year. But while Section 106 continues to make an important contribution to affordable housing delivery, we are getting less from it than we were before changes to the planning system in 2012.

### Section 106 affordable housing delivery 2004/05 to 2015/16 <sup>11</sup>



<sup>10</sup> Shelter, *Addressing our housing shortage: engaging the silent majority*, 2015, p. 33, Chart 23

<sup>11</sup> Brownhill, S and Cho, Y, *Rethinking planning obligations*, 2017, p.6

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Between 2007–08 and 2011–12, even as the housing market suffered its worst downturn in a generation, Section 106 delivered an average 27,000 homes a year – amounting to 52% of all affordable homes. This is 10,000 more affordable homes per year than have been achieved in the much more buoyant market of recent years.

New research from Shelter, detailed in Chapter 3 of this report, provides compelling evidence that the principal driver of this under-delivery of affordable housing from Section 106 agreements since 2012 is the increased use of viability assessments by developers.

## What are viability assessments?

In 2012, the Coalition government attempted to boost sluggish markets for land and housing following the last recession through development-friendly measures in its National Planning Policy Framework (NPPF). The framework relaxed obligations on developers to provide community benefits as part of new developments, with the aim of improving the profitability of individual housing schemes so that landowners would sell and developers would build. It did this by guaranteeing ‘competitive returns’ to both landowner and developer:

‘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 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.’

National Planning Policy Framework, paragraph 173

This means that where a developer can demonstrate that building homes in line with local policies would stop a scheme from delivering ‘competitive returns’, they can submit a viability assessment to the council to argue down the level of community benefits that they must provide. In this way, the NPPF weakens local planning policies in favour of underwriting developers’ profits. Thus, the benefits of new housing development have shifted away from local communities since 2012.

But the biggest beneficiaries of this process are not in fact developers themselves – although many have done well in recent years – but landowners, who have seen the value of their holdings shoot up as developers suddenly have more to spend in a highly competitive land market. This is because of the way that the expected costs and benefits of development feed through to land prices, a process demonstrated by the ‘residual land valuation’ methodology.

## Residual Land Value



The first and most important ingredient of any development is land. To decide how much to pay for land, developers make a calculation known as the 'residual land valuation'.

This starts with an estimate of the Gross Development Value of the planned housing scheme – what the developer expects to be able to sell the homes for at the end. It then subtracts the

developer's profit and the total costs of carrying out the development, including community benefits like affordable housing. The remaining amount, the Residual Land Value, is the amount the developer can pay the landowner.

If a developer can drive down the amount of community benefit, they will be able to pay more for the land. And conversely, if the community benefits are higher, there is less leftover to pay the landowner, resulting in a lower land price.

To determine whether a scheme is viable and provides a 'competitive' return, two measures of land value are assessed: the Residual Land Value described above, and the Benchmark Land Value. This is the minimum amount needed to incentivise the landowner to sell. If the Residual Land Value is greater than the Benchmark Land Value, then the scheme is viable.

### Non-viability: landowner returns and developer returns

There are two ways in which a scheme can be considered 'non-viable'. If the land price is so low that the landowner has no incentive to sell, the scheme will not go ahead – it is said to be 'non-viable', as it does not yield enough profit to the landowner. Some sites can even have 'negative land value', where the costs of development exceed the value of the completed scheme.

Similarly, if the developer pays too much for the site, or if sale prices look like they will not match their expectations, the developer risks seeing their profit margin squeezed. In these circumstances, they may well halt the scheme and wait for more favourable market conditions.

There is therefore a risk that if the local planning authority demands more in community benefits than can be supported by planning gain in the local area, schemes will be rendered non-viable and will not get built – either because landowners will not sell, or because developers will not build.

The first of these risks – that development is not viable for the landowner – is best managed at the Local Plan level, and by using public subsidy where

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appropriate. If public policy, as set out in the Local Plan, demands a site use that will not generate sufficient value to pay for the development itself, it is up to the public authorities to either subsidise the viability gap, or adjust their expectations. Shelter's views on how public authorities and other development actors can drive better outcomes through strategic planning and land use are set out in our [New Civic Housebuilding](#) report.

The second risk – that development is deemed non-viable to the developer – is currently managed through the Section 106 system on a site-by-site basis, by allowing developers to submit viability assessments, and requiring local authorities to consider these in negotiating the level of community benefit they demand. This system is the focus of this report.

Some planned housing schemes can become unviable to the developer for genuine, unforeseeable reasons, for example when a site turns out to have abnormally high remediation costs that could not possibly have been picked up in earlier surveys. In such cases, the developer could make a loss if they went ahead and built the homes anyway, so there would be no incentive to build. There is a role for viability assessments in such genuinely unforeseeable, exceptional circumstances, to assess the level of subsidy or alternations to the scheme which would be needed to see it built out.

The problem is that viability assessments are being used routinely on schemes where no such circumstances apply. In fact, Shelter's new research finds that in the year 2015-16, viability assessments were submitted on 44% of new housing schemes across nine English cities. Far from being a tool to deal with exceptional circumstances, viability assessments have become normalised. This is the viability loophole that is cutting affordable homes by 79% – and undermining the workings of the entire English planning system.

### **Why do viability assessments target affordable housing?**

Viability squeezes a whole range of community benefits, as well as design standards and the sizes of new homes, all of which are costs to the developer. In a recent survey of local authorities from LGiU and Ramblers, eight in 10 councils said viability assessments stop new developments from supporting health and wellbeing, active travel and access to green spaces.<sup>12</sup>

But by far the biggest reductions have been seen in the affordable housing provided as part of new developments, with fewer affordable homes built overall and a shift away from the most affordable rented homes towards more expensive tenures. There are two major reasons why affordable housing is nearly always the casualty in viability negotiations:

- 1) Other elements which might be squeezed to increase profits are often legally necessary for the development to proceed. A new development

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<sup>12</sup> Survey of 118 officers from local authorities across England: LGiU, *Building connected communities: An LGiU/Ramblers survey*, 2017, p.6

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which cannot secure a road to connect it to the existing town will simply not go ahead, for example. Councils are often faced with a choice between agreeing to reductions in affordable housing or having a stalled development blighting the local area.

- 2) From the developer's point of view, investing in a new school or better transport is likely to increase the sales value of the private homes on a scheme, while affordable homes just take up space on a development that could be used for more profitable private housing.

## What is wrong with viability assessments?

There are five major problems with the way viability assessments are currently used, resulting in the avoidable loss of thousands of affordable homes on new housing developments every year:

### **1. The rules allow developers to define their own 'competitive returns'**

With no official definition, developers have been left to define for themselves what level of return is 'competitive'. Following the housing market crash in 2008, expected returns rose from around 14% to 20% of the Gross Development Value because of increased risk at the time.<sup>13</sup> The NPPF has enabled expected returns to settle at these higher levels as a new 'market norm' – despite lower interest rates, a less risky development environment and lower returns elsewhere in the economy. Without viability assessments, it is difficult to see how 20% profits would have been sustained.

As things stand, developer profits of 20% have become accepted as a standard, fixed input in viability calculations. When councils refuse planning permission to developers seeking to reduce affordable housing contributions on viability grounds, the Planning Inspectorate upholds this 20% profit level at appeals, simply because that is what developers say they require.

An appeal decision confirming the loss of 950 affordable homes in Wokingham, down from 40% of the housing scheme to 2%, demonstrates the situation well:<sup>14</sup>

'The appellants supported their calculations by providing letters and emails from six national housebuilders who set out their net profit margin targets for residential developments. The figures ranged from a minimum of 17% to 28%, with the usual target being in the range 20-25%... I conclude that the national housebuilders' figures are to be preferred and that a figure of 20% of GDV, which is at the lower end of the range, is reasonable.'

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<sup>13</sup> BNP Paribas Real Estate, Affordable Housing Viability Assessment: Prepared for London Borough of Islington, 2009, p.8

<sup>14</sup> The Planning Inspectorate, Appeal Decision APP/X0360/A/12/2179141, 2012, p.10

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Housing schemes must deliver a profit for developers. Otherwise they will have no incentive to build. Developers do make a return on affordable housing – typically around 6%, reflecting lower levels of risk when sale to a social landlord is guaranteed.<sup>15</sup> But the NPPF has unwittingly created a state-backed fixed-return of 20%, independent of market conditions, development risk or performance, and at the expense of communities' needs for affordable housing.

## **2. The rules allow developers to create their own methods for assessing viability**

There are no standards for how viability assessments are put together, and viability evidence used in Planning Inspectorate appeals is not subject to rules of expert evidence. This has left the door open for developers to produce calculations that strengthen the case for cutting down affordable housing numbers.

There are huge variations in the way different methodologies handle tax, analyse risk, and predict sales values. For example, development finance can be input as 100% debt, with interest, regardless of whether loans are actually used to undertake the development.<sup>16</sup> The consultants employed by developers to provide viability assessments routinely provide multiple assessments, showing very different results, based on different assumptions.

The broad freedom developers have had in creating their own viability assessment methodologies has resulted in schemes being portrayed as unprofitable for viability purposes before being sold on for significant returns. In the case of a development in Southwark at 237-247 Rye Lane in 2014, the Planning Inspectorate agreed with the developer that the Residual Land Value was £0.955 million and the Benchmark Land Value was £0.912 million. The developer went on to sell the site for £4.6 million within the next six months.<sup>17</sup> Guidance is essential to ensure viability assessments reflect reality as closely as possible.

## **3. Viability assessments are kept secret from the public – and even from councils**

National Planning Practice Guidance (NPPG) states that negotiations over viability should be 'open book', but in practice this rarely happens. Despite their critical role in determining how much local communities will benefit from new housing developments, viability assessments are not usually available to public scrutiny, on the grounds that they contain commercially sensitive information. They can even be hidden from council planning committees, who must then make decisions about whether to grant planning permission to schemes which

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<sup>15</sup> Industry standard. See, for example, BNP Paribas Real Estate, *Affordable Housing Economic Viability Assessment Update: Prepared for London Borough of Wandsworth*, 2013, p.20

<sup>16</sup> See, for example, *January 2016 viability assessment attached to Bristol development15/06400/F*: "Finance costs have been assumed at a debit rate of 6.5% inclusive of set up and exit fees. We consider that these rates are within normal market parameters."

<sup>17</sup> Sayce, S et al., *Viability and the Planning System*, 2017, p.42

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are not policy compliant. This is the case even when viability is used to argue down community benefits on public land.

Councils such as Bristol as well as the Mayor of London have taken action to make viability assessments public if developers propose to reduce planning obligations below policy requirements. Transparency has not deterred development in these areas.

There are cases where genuinely unforeseeable circumstances mean that a housing scheme which has already been approved will need to receive subsidy or be altered in order to go ahead, and it may be in communities' interests for this to happen. However, there are no cases where it is in communities' interests for viability negotiations to be cloaked in secrecy. If developers want to make the case for why a site cannot meet a minimum affordable housing contribution or provide promised local services, at the very least local people should know why.

#### **4. Conflicting guidance on how Benchmark Land Values are defined has led to circularity, guaranteeing affordable housing reductions**

By far the most problematic area in the current use of viability assessments is how the Benchmark Land Value is assessed (see page 14). The NPPG gives contradictory guidance on how benchmark values should be worked out, leading to conflict rather than clarity.

Some developers have successfully argued in appeal cases that the actual price paid for the land should be used for the benchmark value.<sup>18</sup> This produces circularity, because developers know that if they overpay for land on the basis of providing less affordable housing (inflating the benchmark value) they can later use a viability assessment to show that the scheme can only be rendered viable by reducing affordable housing or other community benefits.

In other words, developers are planning out affordable homes at the land bidding stage, deliberately paying sums for land that then make the scheme that follows unviable – unless the council compromises on its affordable housing policy. With the developer's return and the land cost treated as fixed inputs in the viability assessment, significant risk has been transferred to the community. Yet the same developers continue to target the 20% level of profit, which was originally justified on grounds of high development risk.

There are many alternatives to using the inflated prices paid in the dysfunctional land market in viability assessments. The approach taken by the Mayor of London in recently published supplementary planning guidance is to base the Benchmark Land Value on Existing Use Value plus a clear premium (EUV+), enabling a clear comparison between the value of the site without planning permission and the Residual Land Value.

In all cases, affordable housing policy and other community benefits should be included in the costs used to calculate land values. In 2015, the then Secretary of

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<sup>18</sup> See, for example, The Planning Inspectorate, Appeal Decision APP/X5210/S/15/3133785, 2016

State<sup>19</sup> and the Royal Institution of Chartered Surveyors<sup>20</sup> made clear their expectation that land values must reflect local planning policies:

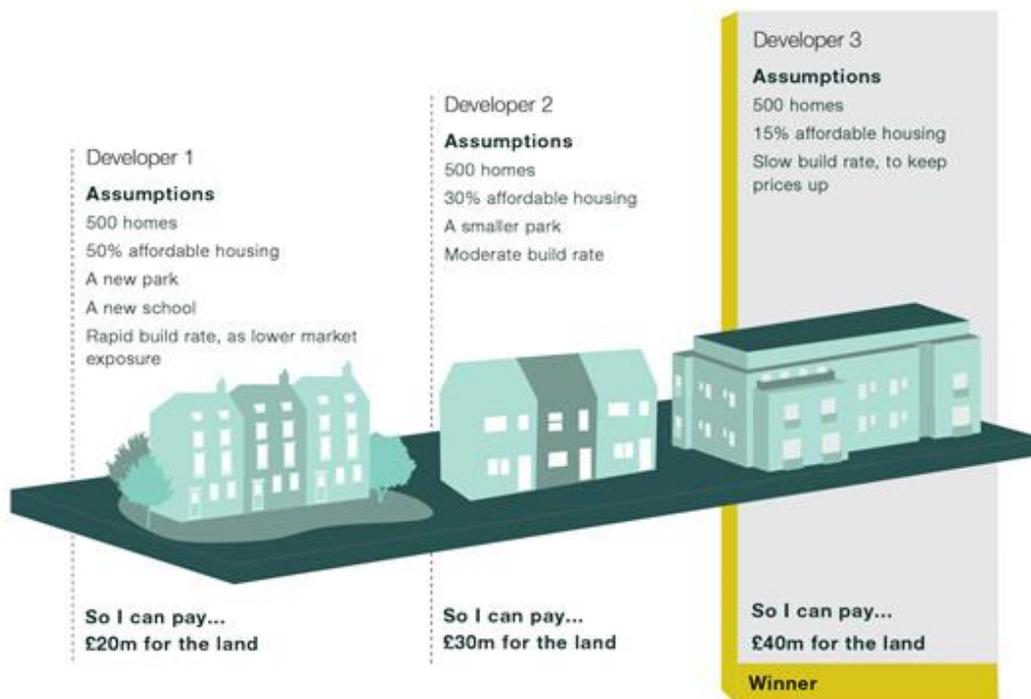
'A correct application of market value would protect the community from changes in market state and ensure that any site brought forward for development would be able to provide policy compliant planning obligations.'  
RICS

It is a clear failing of the planning system that current rules do not achieve this.

### 5. Developers have to use viability assessments in order to remain competitive

We cannot be surprised when developers respond to opportunities to guarantee their profits and outbid their competitors. Private developers' first duty is to maximise returns to their shareholders. It is up to government to set planning rules and guidance that will get what communities need from new housing developments, and provide a level playing field for developers.

Instead, national planning rules have introduced skewed incentives, guaranteeing that affordable homes will be squeezed out. If one developer doesn't plan on using viability, another developer will – and that developer will be able to offer the landowner a higher price in a highly competitive market for land. In this way, developers are locked in a race to the bottom.



The developer who makes the worst assumptions about the level of affordable housing to be provided on the scheme will always win the site. The same is true

<sup>19</sup> 24housing, "Council welcomes government position over 'paying too much' for land", 23 November 2015

<sup>20</sup> RICS, *Financial Viability Appraisal in Planning Decisions: Theory and Practice*, 2015, p.26

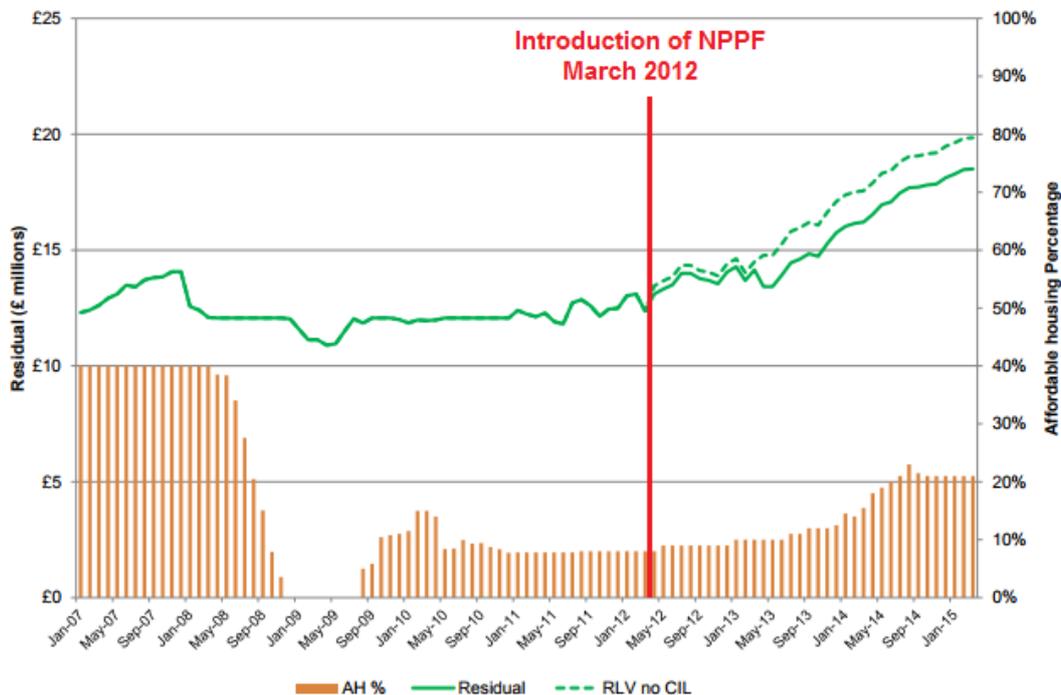
for transport and infrastructure, quality design, the sizes of new homes – or anything else the local community might have expected from the development. They all get squeezed by viability assessments.

For developers, the viability system guarantees a high but stable level of return at around 20%. For landowners, the viability system ensures that they get as much as possible of the Gross Development Value of a scheme, inflating their returns. The losers are ordinary people who have to put up with housing that is unaffordable, poor quality, and does not come with the investment in local infrastructure and services needed to turn flats and houses into places people want to live in and next to.

## How viability rules have inflated land values

As the land and housing markets have recovered from the 2008 crash, the NPPF has continued to enable the use of viability assessments to argue down planning obligations. As such, affordable housing delivery has made only a slow and partial recovery, while land prices have shot up against their pre-recession values. Flexibility in the viability system has driven down affordable housing provision at the expense of land price inflation, making good development more expensive.

### Modelled residual Land Values since 2007<sup>21</sup>



Just as flexibility in the provision of affordable housing and other community benefits has pushed up land prices, certainty around the level and type of

<sup>21</sup> Data modelled using new build house prices from HM Land Registry, UK House Price Index; Reproduced with the kind permission of Dr Anthony Lee of BNP Paribas Real Estate

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affordable housing required on new developments - backed up by amendments to the NPPF and NPPG - will filter through to land values, suppressing them to levels which allow for policy-compliant schemes. Evidence from the implementation of the Community Infrastructure Levy, charged to new developments at fixed, non-negotiable levels, demonstrates this effect.<sup>22</sup>

Likewise, the costs of affordable housing will be passed on to landowners in the form of reduced (but still substantial) returns, as comments from Berkeley Group chairman Tony Pidgley arguing for a fixed rate of affordable homes suggest:<sup>23</sup>

'If you tell us guys to produce 30 per cent affordable, we will adjust the land value... We all know land values have doubled in the past five years.'

But developers can only play by the rules national planning laws set for them. Shelter's recommendations for resetting these rules are detailed in Chapter 5 of this report.

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<sup>22</sup> DCLG, *The value, impact and delivery of the Community Infrastructure Levy*, 2017, p.8

<sup>23</sup> Planning Resource, "[Top housebuilder urges ministers to impose 30% affordable housing on big schemes](#)", 17 March 2016

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# CHAPTER 3: NEW EVIDENCE – AFFORDABLE HOUSING SHORTFALLS IN NINE ENGLISH CITIES

The role of viability assessments in pushing down affordable housing delivery is well known across the planning and housebuilding industries. However, the scale and geographical spread of the problem has remained largely hidden until now, because viability assessments themselves are usually confidential documents. What information is available is fragmented and difficult to find. To address this evidence gap, Shelter has undertaken research to demonstrate the impact of viability assessments in urban areas across the country.

## Research method

The research, conducted with property market experts EGi, assessed 179 planning permissions, collected from 11 local authorities across nine cities in England: Newcastle upon Tyne, Manchester, Leeds, Leicester, Birmingham, Oxford, Cambridge, Bristol, and the three London councils of Brent, Southwark, and Kensington and Chelsea. The three London councils were selected to represent the distinct housing markets found in outer London, inner London and ‘prime’ central London.

The research compares the levels of affordable housing included on sites given planning permission with the levels required by local authority affordable housing policies. Where we identified a shortfall of affordable housing on a development, the research used local authority planning portals to assess whether a viability assessment was used to negotiate down affordable housing numbers.

The research assesses all planning permissions approved in the financial year 2015–16<sup>24</sup> relating to schemes which would normally be required to have affordable housing. National policy has removed affordable housing requirements from schemes of under 10 homes since November 2014, and some local authorities have additional exemption policies. For example, Birmingham does

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<sup>24</sup> The financial year 2015-16 covers the period during which the Growth and Infrastructure Act 2013 gave additional scope for developers to use viability assessments to argue down affordable housing numbers, including the right to appeal directly to the Secretary of State and the right to appeal an agreed Section 106 contract within the first five years of a planning permission. These provisions expired in April 2016. However, they have been effectively extended by the Housing and Planning Act 2016, which empowered the Secretary of State to make regulations which “may impose restrictions or conditions on the enforceability of planning obligations entered into with regard to the provision of (a) affordable housing; or (b) prescribed definitions of affordable housing”.

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not require affordable housing on schemes under 15 homes. Such schemes were not included in the research.

In this research, the term ‘affordable housing’ refers to the official government definition,<sup>25</sup> including social rent, Affordable Rent, Shared Ownership and other intermediate tenures. The split between these tenures varies by area and by scheme. The term ‘affordable’ in this context does not necessarily mean that these homes are in fact affordable to local people – a problem that Shelter has repeatedly highlighted and continues to campaign on.<sup>26</sup>

## Research findings

The research reveals that developers used viability assessments to get out of building more than three-quarters of the homes that local policies required across these 11 local authorities.

Overall 2,500 potential affordable homes were lost on sites where viability was used by the developer.

Viability assessments are by far the most important factor explaining why these communities did not get the affordable housing promised in local policies. Of a net 2,525 affordable homes lost last year across these cities, 2,500 (99%) were lost from schemes where the developer submitted a viability assessment.

### **Developers have successfully slashed affordable housing numbers using viability assessments**

Where viability assessments were used, new housing sites achieved just 7% affordable housing. This is far below the affordable housing policies of the local authorities in this study, which vary by area but on average require that 28% of new homes built should be affordable homes. Where viability was not used, 24% affordable housing was achieved.

This amounts to 2,500 affordable homes lost in just one year on schemes where developers submitted viability assessments, equivalent to a 79% reduction in affordable housing compared to the levels required by council policies. This is happening in some of the country’s least affordable areas, where these homes are most needed.

### **Viability assessments have become normalised in the planning system**

Viability assessments were used to knock down affordable housing on almost half (44%) of new developments in the study, rising to 63% of schemes in Birmingham and 77% in Kensington and Chelsea.

Over time, the loss of affordable homes from viability can have a significant impact on a local area’s housing stock. Additional Shelter research conducted using the same methodology shows that between 2012–13 and 2015–16,

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<sup>25</sup> <https://www.gov.uk/guidance/definitions-of-general-housing-terms#social-and-affordable-housing>

<sup>26</sup> See, for example, <http://blog.shelter.org.uk/2015/08/what-is-affordable-housing/>

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Kensington and Chelsea lost out on 470 affordable homes, including 459 social rent homes which would have been affordable to those on the lowest incomes.

### **Developers of large schemes are far more likely to argue down affordable housing numbers**

Viability is used much more often on large housing schemes compared to smaller sites. The average number of homes on sites where viability was used was 130, compared to an average of 73 on schemes with no viability assessment. So while viability was used on only 44% of sites in the study, these accounted for 58% of the homes in our sample.

This has implications for competitiveness and the overall efficiency of the housebuilding sector, skewing opportunities in favour of big developers building big sites, while those building smaller schemes<sup>27</sup> are more likely to play by the rules and lose out financially.

### **We are missing out on affordable homes all over the country because of viability assessments**

So far, there has been more research into the role of viability assessments in reducing affordable housing numbers in London than elsewhere. But this study reveals drastic reductions in cities all over England. In just one year, sites where developers submitted viability assessments saw:

- 1,003 affordable homes lost in Birmingham. Just 18 out of a staggering 2,916 homes were affordable – less than 1% of the total.
- 472 affordable homes lost in Manchester. None of the 2,362 homes permitted on sites where developers used a viability assessment were affordable.
- 338 affordable homes lost in Leeds. Just 8% affordable housing was achieved on sites where developers submitted viability assessments, compared to 17% affordable housing elsewhere.
- 196 affordable homes lost in Bristol. Just 8% affordable housing was achieved on sites where developers submitted viability assessments, compared to 30% affordable housing elsewhere.

### **The use and impact of viability varies considerably by area**

While the viability loophole is not restricted to any one part of the country, the local authorities in this study show considerable variation in how often viability assessments are used and how many affordable homes new housing schemes lose as a result. This partly reflects differences in local housing markets and partly results from differences in local policies and practice.

Some councils, like Cambridge, have developed effective strategies for limiting the use of viability assessments through local policy, helped by strong demand

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<sup>27</sup> This does not apply to the very smallest schemes under 10 units, which have been exempt from affordable housing requirements since November 2014.

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from developers to build there. As such, developers know that developments are expected to include 40% affordable housing and have factored this into the price they offer to landowners. Cambridge has seen similar or higher house price growth than other markets – yet land values are no higher than they were at the 2007 peak of the land market.<sup>28</sup>

Others, like Manchester, give developers clear grounds for arguing down contributions to community benefits in their own local planning policies and guidance. Thus, developers may not even need to put time and money into commissioning viability assessments. They are often able to negotiate down affordable housing numbers on viability grounds in preliminary discussions. This may be why schemes in Manchester delivered particularly low levels of affordable housing both on schemes where a viability assessments was submitted (0% affordable housing) and where no assessment was used (11% affordable housing against a council affordable housing policy of 20%).

In all cases, national planning rules act as hurdle to overcome in getting affordable housing built. Equally, reforming those rules at the national level is the most efficient way to drive up affordable housing supply. We cannot wait for all 326 local planning authorities to learn how to beat developers at their own game.

Full results by local authority follow overleaf.

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<sup>28</sup> Savills, [The value of land: a leveraged bet on house prices?](#), 4 June 2015, Figure 4

Region	Schemes	Homes	% Affordable housing achieved	Affordable housing shortfall
<b>BIRMINGHAM</b>	Birmingham has an affordable housing policy of 35%			
Viability used	20	2916	1%	1003
Viability not used	12	876	36%	-8
<b>BRENT</b>	Brent has an affordable housing policy of 50%			
Viability used	5	612	25%	153
Viability not used	5	73	51%	-1
<b>BRISTOL</b>	Bristol has an affordable housing policy of 20-40%			
Viability used	8	746	8%	196
Viability not used	7	384	30%	3
<b>CAMBRIDGE</b>	Cambridge has an affordable housing policy of 40%			
Viability used	0	0	0%	0
Viability not used	6	438	38%	7
<b>LEEDS</b>	Leeds has an affordable housing policy of 5-35%			
Viability used	8	1654	8%	338
Viability not used	20	1897	17%	-91
<b>LEICESTER</b>	Leicester has an affordable housing policy of 15-30%			
Viability used	2	115	0%	17
Viability not used	4	85	27%	-6
<b>MANCHESTER</b>	Manchester has an affordable housing policy of 20%			
Viability used	17	2362	0%	472
Viability not used	24	1911	11%	178
<b>NEWCASTLE</b>	Newcastle has an affordable housing policy of 15%			
Viability used	1	280	0%	42
Viability not used	10	923	37%	-202
<b>OXFORD</b>	Oxford has an affordable housing policy of 50%			
Viability used	0	0	0%	0
Viability not used	6	497	32%	92
<b>SOUTHWARK</b>	Southwark has an affordable housing policy of 35%			
Viability used	8	1233	26%	117
Viability not used	3	144	19%	23
<b>KENSINGTON &amp; CHELSEA</b>	Kensington & Chelsea has an affordable housing policy of 50%			
Viability used	10	326	0%	163
Viability not used	3	58	0%	29

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# CHAPTER 4: BENEFITS OF CLOSING THE VIABILITY LOOPHOLE

## Provide more affordable homes

The challenge of driving up housing supply, and particularly of affordable housing, can seem enormous. However, this is a rare case of a clear problem with a clear solution. Closing the viability loophole could deliver thousands more affordable homes every year to start meeting the housing needs of those excluded from the market. Because affordable housing provided through Section 106 is financed from the increase in land values resulting from planning permission, most of these additional homes could be provided without additional public money, which could instead be invested in meeting other housing priorities – like lowering rents to genuinely affordable levels.

The benefits of closing the viability loophole for affordable housing are obvious. But it would also bring broader benefits. The decision to relax planning obligations through viability was taken to boost sluggish markets for land and housing following the last recession, with the aim of driving up overall supply. In fact, viability assessments are now exacerbating an over-reliance on a small number of developers and a lack of diversity in housing output, hampering overall supply.

A strictly limited, fair and transparent system of viability assessments can play an important role in fixing the country's broken housing market, improving efficiency and competition in the housebuilding sector, speeding up the rate at which new homes are built and boosting public support for new developments. Some of these opportunities are explored below.

## Create more opportunities for those building smaller sites, increasing overall housebuilding capacity

Viability is used much more often on large housing schemes than on smaller sites. The average number of homes on sites where viability was used was 130, compared to an average of 73 on schemes with no viability assessment. Developers who make use of viability assessments spend significant sums on expert consultants to evidence their viability claims and take their cases to appeal. These costs are more likely to prove economical on large housing sites, with significant sales values at stake, than they are on smaller schemes.

This has implications for competitiveness and the overall efficiency of the housebuilding sector. If developer returns on larger sites are underwritten by flexible affordable housing policy while those on smaller sites are not, the system of viability assessments may be unintentionally providing a competitive edge to

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developers building out larger sites. This would disincentivise the use of smaller and infill sites, which represent important opportunities in built-up areas.

There is a broad tendency for big developers to build out larger sites, while smaller sites often attract small and medium sized developers and specialist housebuilders, as well as custom- and self-builders. As a result, closing the viability loophole would create a more level playing field between different types of developer, improving competition and providing a much-needed boost to capacity within the housebuilding sector.

## Increase the overall pace of building and increase total new supply

As organisations such as the Chartered Institute of Housing have pointed out,<sup>29</sup> the ease with which developers can use viability assessments is pushing down overall housing supply. A housebuilding system which is over-dependent on housing for private sale to make up overall numbers will find itself unduly constrained by natural limits to demand. Developers can only build homes for sale as fast as they can sell them – and there is only so much money chasing homes for sale. That’s why private development on its own has never come close to delivering the 250,000+ homes a year we need to keep up with demand.

By contrast, there is a guaranteed and instant market for affordable homes for rent, helping to de-risk development and getting sales receipts in quickly. Lichfields analysis shows that large sites delivering 30%+ affordable housing have build-out rates 40% higher than those of large sites delivering only 10-19% affordable housing.<sup>30</sup>

In addition, closing the viability loophole would cut out whole phases from the processes of granting, revising and appealing planning permissions. A faster, simpler planning system with more certainty for landowners, developers, councils and communities would boost the speed at which we can get new homes built.

## Increase local support for new housebuilding

Previous Shelter research has found that people are much more likely to support new housing in their area when it is affordable and comes with improvements to local roads and infrastructure, additional funding for services and facilities and jobs – the things which reassure communities that they will not lose out from an expanded population and which make the disruption of local building work worthwhile.<sup>31</sup> When the new homes being built are affordable to local people on average incomes, the level of public support jumps from 57% to 73%.<sup>32</sup>

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<sup>29</sup> CIH submission to the Autumn Statement 2016

<sup>30</sup> Nathaniel Lichfield & Partners, *Start to finish: how quickly do large-scale housing sites deliver?*, 2016, p.3

<sup>31</sup> Shelter, *Addressing our housing shortage: engaging the silent majority*, 2015, p. 33, Chart 23

<sup>32</sup> NatCen’s British Social Attitude survey 2016

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What many people object to is not housebuilding nearby, but plans for homes no one they know will ever be able to afford. We cannot be surprised when communities are reluctant to accept developments which put pressure on local services and infrastructure without offering anything back.

The viability industry contributes directly to this problem by reducing the benefits existing communities see from new developments, as developers use viability assessments to get out of building affordable housing and paying for transport, wider infrastructure and services. By closing the viability loophole, the government can drive up public support for new housing schemes, speeding up their passage through the planning system and getting everyone pulling in the same direction to tackle the housing crisis.

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## CHAPTER 5: RECOMMENDATIONS

The damage being done by viability assessments is clear to see. Fortunately, there is a simple solution. By following through on plans to amend national planning rules in the [Planning for the right homes in the right places](#) consultation, the government can deliver thousands more affordable homes every year, increase overall housing supply and make sure communities get more of what they want from new housing schemes.

Just as flexibility in the provision of affordable housing and other community benefits has pushed up land prices, certainty around provision, backed up by amendments to the National Planning Policy Framework and National Planning Practice Guidance, will filter through to land values, suppressing them to levels which allow for policy-compliant schemes. This is what happened when the introduction of Community Infrastructure Levy produced fixed, non-negotiable local policies for funding certain kinds of infrastructure: the payments have ‘come off the land value’.<sup>33</sup>

It is time for central government to provide the framework to achieve the same certainty for other community benefits, above all affordable housing.

### Recommendation 1: Strengthen Local Plans

Local authorities set policy requirements around affordable housing and other community benefits when writing their Local Plans, which are then viability tested at the plan level. This practice should be strengthened, with central government providing guidance on the best available evidence for councils to use when writing Local Plans and for the Planning Inspectorate to use when examining them.

This process will be supported by closer definition of the planning use or uses which a local authority is willing to consider for particular sites in the Local Plan. Owners of sites which the local authority wishes to see developed for residential use should know that they will not receive any alternative planning permission for an extended period, providing increased certainty and supporting the process of assessing Benchmark Land Values. Shelter’s views on how public authorities and other development actors can drive better outcomes through strategic planning and land use are set out in our report [New Civic Housebuilding](#).

Local Plans should identify the infrastructure and affordable housing needed, both to keep up with demand and to meet plans for growth. Councils should then provide implementation plans including the funding sources available at the time that the plan is written and how much need can be met in these ways - including through developers’ on-site affordable housing contributions. Where there is a

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<sup>33</sup> DCLG, *The value, impact and delivery of the Community Infrastructure Levy*, 2017, p.8

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deficit between the affordable housing and infrastructure needed and what can be delivered using available public and private resources, the plan should outline what need will be prioritised and why. These implementation plans should then be tested for viability with the aim of ensuring that as much of the identified need as possible will be met through the available resources. By clearly stating what is needed, Local Plans should inform decisions on funding for housing and infrastructure at all levels of government.

As indicated in the [Planning for the right homes in the right places](#) consultation, viability-tested, evidence-based policies in Local Plans will remove the need for site-level viability assessments except in a strictly-defined set of exceptional circumstances (see Recommendation 2).

Affordable housing commitments agreed in this way must be understood as policies – not as targets. Policies should include the percentage of habitable rooms to be affordable, the split between tenures and sizes of homes, and whether homes are targeted at particular demographic groups, such as housing for older or disabled people. These decisions should be based on evidence about housing need in the area and available resources in the form of planning gain, subsidy, and so on.

For plan-level viability testing to be sufficient in the majority of cases, it must be applied in a nuanced way. Local authorities should identify diversity in their local housing and land markets when writing the Local Plan, producing tailored affordable housing policies. Councils including Sheffield, Leeds and Bristol already do this, varying the levels of affordable housing required in line with the expected land value uplift for different areas. In addition, Local Plans should contain councils' policies around commuted sum payments, the circumstances in which they are acceptable and how they will be used to meet local housing priorities.

Locally set, fixed affordable housing policies should be introduced over a two-year implementation period to protect the development pipeline and give landowners and developers adequate time to adjust, in line with proposals from the Planning Officers Society.<sup>34</sup>

## **Recommendation 2: Limit the use of site-level viability assessments to a strictly-defined set of exceptional circumstances**

Some planned housing schemes are genuinely unviable – for example, where a site turns out to have abnormally high remediation costs that could not possibly have been picked up in earlier surveys. There is a role for site-level viability assessments in such genuinely unforeseeable, exceptional circumstances, where subsidy or alterations to the scheme are needed to avoid sites becoming stalled.

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<sup>34</sup>Kiely M, *Planning for a better future: delivering affordable housing in a more effective way*, Planning Officers Society, 2016, p.4

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However, site-level viability assessments should not be used to manage normal market risks, such as sales values being lower than a developer bet on when purchasing land.

Central government should produce new rules on the limited circumstances in which site-level viability claims at the planning application stage will be considered, with clear evidence standards for determining these circumstances, and guidance on how to plug viability gaps - for example by drawing on the Housing Infrastructure Fund.

### Recommendation 3: Incentivise policy-compliant schemes

In the limited circumstances where site-level viability assessments are used, national planning policy and guidance should ensure that they operate as fairly as possible, and that developers fully explore every alternative to reducing affordable housing numbers.

Drawing on the approach taken by the Mayor of London in recently published supplementary planning guidance,<sup>35</sup> policy-compliant schemes should be prioritised in the planning system and rewarded with faster approval. Developers promoting non-compliant schemes using the new system for site-level viability assessments outlined in Recommendation 2 should be required to apply for public funding to plug viability gaps and explore options for redesigning schemes that do not impact on the level of community benefits to be provided.

In cases where a reduction in community benefits is identified as the only way to render a scheme viable, national planning policy should mandate the use of review, clawback or overage clauses so that when sales values exceed those anticipated at the time of the site-level viability agreement, the greater Gross Development Value is used for community benefits. This will ensure that whenever the community takes on the downside risks of development, it also gets the upside potential. On the other hand, where a developer builds new developments as per local policy and retains downside risk, they should be free to maximise their returns.

### Recommendation 4: Redefine and clearly justify the level of returns to be supported by the planning system

The aim of plan-level viability testing should be to ensure that landowners put land into development and developers build schemes. Returns should be supported by the planning system only up to the level necessary to achieve these results.

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<sup>35</sup> Mayor of London, *Homes for Londoners: affordable housing and viability supplementary planning guidance 2017*, 2017

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## Benchmark Land Values

The National Planning Policy Framework and National Planning Practice Guidance should be revised to address clashing objectives around Benchmark Land Values and provide clarity on the point that land values must reflect policy requirements. The definition of the benchmark value in NPPG should be amended to: ‘the value below which the site will be retained in its existing use’.

When calculating benchmark values for viability assessments, there are many alternatives to looking at prices paid in the dysfunctional land market. The approach taken by the Mayor of London in recently published Supplementary Planning Guidance is to base the Benchmark Land Value on Existing Use Value plus a clear premium (EUV+). Shelter advocates an approach based on Existing Use Value to enable a clear comparison between the value of the site without planning permission and the Residual Land Value. It should then be up to local planning authorities to determine how best to calculate premiums. Some will use a percentage of the Existing Use Value itself, while others may use a percentage of the Residual Land Value to ensure landowners are adequately incentivised to put land into development.

There will remain a risk that landowners will withhold their land from development in an attempt to force a change in policy. This should be addressed by strengthening Compulsory Purchase Order powers, using a revised compensation code, to provide a strong disincentive against holding out.<sup>36</sup>

## Developers’ returns

Paragraph 173 of the National Planning Policy Framework should also be amended to remove the phrase ‘competitive returns’ and replace it with ‘a return’.

To ensure that it is more profitable for developers to build than to do nothing, Local Plans should be written and viability-tested based on risk-adjusted returns appropriate for local housing markets and the broader development environment. Central government should provide guidance for local planning authorities to determine the level of return to be used when writing Local Plans and assessing levels of planning gain.

Where a developer builds new developments according to local policy and retains downside risk, they should be free to maximise their returns. In the limited circumstances where site-level viability assessments are used, national planning policy should support ‘a return’, ensuring that it is more profitable for developers to build out the site than to leave it stalled. We would recommend combining this with powers for local authorities to tax stalled sites.

It is not the business of the planning system to guarantee any particular level of return. A core principle of the planning system is that planning permission is attached to land and to buildings, not to any owner or developer. The individual circumstances of the current owners and their expected and anticipated profit

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<sup>36</sup> See Grayston R, [Financing the infrastructure and new homes of the future: the case for enabling acquiring authorities to purchase land for strategic development under a special CPO compensation code](#), Shelter, 2017

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margins should therefore not determine planning permissions. If plan-level viability testing indicates that affordable housing policies could realistically be funded from the planning gain and grant available at the time of Local Plan approval, it should be left to private developers to create returns from private developments.

Removing protection for ‘competitive returns’ and replacing it instead with a duty for schemes to deliver ‘a return’ will also recognise and incentivise an increasing diversity of development models, responding to the recent flourishing of local authority housing companies, joint vehicles, and other delivery models outside the mainstream, speculative development model.<sup>37</sup>

### **Recommendation 5: Where site-level viability assessments are used, make all evidence fully transparent**

There are cases where genuinely unforeseeable circumstances mean that a housing scheme will need to receive subsidy or be altered to go ahead, and it may be in communities’ interests for this to happen. However, there are no cases where it is in communities’ interests for viability negotiations to be cloaked in secrecy. If developers want to make the case for why a site cannot meet a minimum affordable housing contribution or provide promised local services, at the very least local people should know why. Transparency alone is not enough to make a tangible difference to affordable housing output, but it *would* assist communities in understanding local developments and help to raise standards in the use of site-level viability assessments.

All negotiations should be published and open to public scrutiny, with results and supporting documents available online in a standardised, accessible format. Documents which do not meet these standards should be inadmissible as evidence in viability negotiations.

Viability evidence used in Planning Inspectorate appeals must be subject to rules of expert evidence. Central government should produce guidance on how inputs such as tax, risk and sales values are to be calculated to ensure site-level viability assessments reflect reality as closely as possible.

### **Why expanding the commuted sum system would not work**

Some developers and commentators have argued that on-site affordable housing on private developments should be scrapped entirely and replaced with a levy charged on each square foot of development – essentially an expansion of the commuted sum system. A commuted sum (or payment in lieu) is money paid by a developer to the council instead of complying with the council’s affordable housing policy. The developer may provide a smaller number of affordable

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<sup>37</sup> See Hackett, P, *Delivering the renaissance in council-built homes: the rise of local housing companies*, The Smith Institute, 2017

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homes and a commuted sum, or a commuted sum and no affordable homes. Shelter believes this would be ineffective, slow and inefficient as a way of providing community benefits from new development, for the following reasons.

**1. Commuted sums are routinely knocked down using viability assessments**

Just as viability assessments are used to argue down numbers of affordable homes, they are also used to argue down levels of commuted sums.<sup>38</sup> A fixed charge on new development is no solution to the current crisis in affordable housing provision.

**2. Commuted sums often do not get spent on affordable housing supply – or spent at all**

Shelter has evidence that councils have a poor track record of spending commuted sums, and a particularly poor track record of using these sums to build new affordable housing. Information provided by Oxford City Council through Freedom of Information requests revealed that the council received £1,252,536 in commuted sums between 2012–13 and 2016–17, but has built no affordable homes with this money. In fact, not one pound of it has been spent. At best, commuted sums are painfully slow at delivering affordable housing. At worst, they are utterly ineffective.

**3. Mixed development is better for communities**

While in some circumstances it clearly makes sense to accept a commuted sum instead of on-site development (e.g. where the local need is for family homes, but the development in question is high-rise and will not easily accommodate larger properties), Shelter does not believe that the cost of land and the resultant unit cost of housing on a site is, in and of itself, a good enough reason to accept commuted sums. There will always be somewhere else it is cheaper to build. Most people would not suggest building all social housing in the North East, although land values are lowest there. The planning system should be used to promote mixed communities where a range of households have access to infrastructure, services and opportunities.

**4. Mixed development is better for the overall supply of homes**

Affordable housing also has an important role to play in supporting build-out rates on large sites, because it does not displace or disrupt market demand and it supports cash flow, particularly for SME housebuilders. Lichfields analysis shows that large sites delivering 30%+ affordable housing have build-out rates 40% higher than those of large sites

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<sup>38</sup> See, for example, Camden New Journal, "[Planners' fury as firm axes affordable homes as luxury development](#)", 19 May 2016

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delivering only 10-19% affordable housing.<sup>39</sup> The practice of building affordable housing off-site to maximise the proportion of market sale housing on site thus misses an opportunity to achieve faster build rate and to manage risk on a development.

Off-site provision should remain in exceptional cases, for example where a development is for high-density urban living and the affordable housing need is for larger family homes. This should optimally take the form of provision on an alternative site. Registers of surplus public land could be used to help identify donor sites in locations where boroughs and private developers are struggling to find a suitable site. However, the best way of providing affordable housing to meet urgent need for it across the country is to get it built alongside current developments.

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<sup>39</sup> Nathaniel Lichfield & Partners, *Start to finish*, 2016, p.3

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## CHAPTER 6: CONCLUSION

The financial crash was a major shock to our national housebuilding system. It warranted a serious response from Government to minimise the development capacity lost and ensure that developers continued to build. But we cannot expect to subsidise private profits forever, and certainly not at the expense of urgently needed community benefits like affordable homes.

On its own, Section 106 will never meet the country's need for new affordable housing supply. But the current use and abuse of viability assessments means that we are getting less affordable housing out of private developments than we were before and during the crash, and certainly less than we could. Flexibility in the viability system has driven down affordable housing provision at the expense of land price inflation, essentially making development more expensive.

By amending the National Planning Policy Framework and National Planning Practice Guidance to close the viability loophole, we can maximise developer contributions to affordable housing, with knock-on positive effects for overall housing supply, build-out rates and community support for new housing. The government is already consulting on the changes needed to turn affordable housing policies into cast iron pledges. It is now vital that they follow through on these plans.

Shelter helps millions of people every year struggling with bad housing or homelessness through our advice, support and legal services. And we campaign to make sure that, one day, no one will have to turn to us for help.

We're here so no one has to fight bad housing or homelessness on their own.

Please support us at [shelter.org.uk](https://shelter.org.uk)

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Shelter  
88 Old Street  
London EC1V 9HU  
0300 330 1234

[shelter.org.uk](https://shelter.org.uk)