2 December 2019

Examination of the North Essex Authorities
Shared Strategic (Section 1) Local Plan

Andrewsfield New Settlement Consortium & Countryside Properties

Matter 7 - Viability

2. Is adequate provision made for the costs of infrastructure at the GCs in the 2019 Hyas VAU?

See para 3.20 of GLH WofBGC Review of Hyas Viability Assessment, September 2019.

We have not at this stage conducted a detailed review of the infrastructure proposals, but the method followed is reasonable and figures adopted by Hyas are at the higher end of a range of comparable new settlement assessments and together with the applied contingency give comfort that the provision in the appraisal is adequate.

3. Apart from housing delivery rates and infrastructure costs (to be discussed under Matters 5 & 6), a number of other changes have been made to the inputs to the 2019 Hyas VAU compared with the 2017 Hyas VA [EB/013], including:

a) land-use and development breakdown

b) infrastructure costs

c) build costs

d) specific inclusion of flats in the development mix

e) plot external costs

f) sales values

g) plot developer profit rate

h) contingencies

i) proportions of affordable rented and intermediate housing

j) use of inflation rates

Are those changes justified?

Yes.

See GLH WofBGC Review of Hyas Viability Assessment, September 2019.

In summary, Hyas have made adjustments to reflect changing market conditions and new evidence discussed during the Inquiry process.

We note inflation rates have been considered and that the sensitivity of the model to this is significant.

The model is just that. The sensitivity of such a large-scale proposal is extreme and it is always possible to derive a wide range of conclusions at this stage of formulating a scheme. We are in agreement with Hyas on the conclusion that the scheme is viable. Countryside have confirmed the results would enable an experienced developer to invest time and money in further developing the scheme.

4. Are sufficient contingency allowances built into the 2019 Hyas VAU?

Yes.

Hyas have assumed 10% cost contingency, for both build and infrastructure costs in their baseline scenarios across the entire infrastructure package. This is consistent with our own approach. Hyas have then considered the sensitivity of their conclusions with the need to increase infrastructure contingencies up to 40%.

40% contingency rates are understandably used by government on infrastructure projects in early stage business cases and reflect the complexity of defining larger infrastructure schemes, with a wide range of stakeholder interest, at early stages of scheme development.

Experienced developers such as Countryside seek to refine their plans and designs to a point where contingencies are lower or benefits higher before determining if they should commit to delivery. In our view, and that of Countryside, it would be completely inappropriate to apply 40% contingency rates for well understood residential led infrastructure delivery and then judge its material impact on the scheme. Based on £53,000 per unit, an additional 30% contingency on a 12,500 homes allocation would add a contingency of £200m and is a 'worst case' scenario. We are not convinced the infrastructure required to deliver the site is sufficiently challenging or extraordinary to justify a contingency at the higher end of the range.

Our view, supported by Countryside, is that most developers expect to be able to deliver the scheme within a well-developed budget that includes an appropriate contingency of 10-15% as commonly adopted by Countryside. Many of the infrastructure items are not unique and it will be possible to identify appropriate standard design solutions and contractors to deliver requirements within the allowances that have been budgeted. Hyas have applied sensible rates and considered the potential risks involved. Countryside are comfortable that the risks involved in delivering the scheme could be managed.

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5. Is 6%, as employed in the 2019 Hyas VAU, an appropriate rate for the cost of capital?

Yes.

A debit rate of 6% average is within the range of cost of finance assumptions we currently see in appraisals. We would note the rates will be subject to market changes and that different elements of the scheme will have different finance costs, to account for the varying risks involved. For instance, many housebuilders will be able to finance housing schemes for less than 6%. Financing elements of the scheme such as some of the infrastructure elements, may prove more expensive than 6%.

At this stage in the scheme's evolution, 6% debit rate average across the scheme is a reasonable assumption.

6. Accepting the assumption that land will be purchased two years before it is required for development, does the 2019 Hyas VAU correctly calculate interest on land purchase?

Yes, the Hyas calculations in respect of interest on land purchase are correctly made.

7. Is the assumption that land will be purchased two years before it is required for development a sound one to make?

Yes, it is a reasonable assumption for present purposes.

We would expect promoters to seek to minimise the potential period they hold land prior to building on it. Land will be drawn down and/or purchased in phases, when required. This is typically less than two years prior to development. The Hyas assumption is reasonable.

We agree with Hyas that land is likely to be purchased throughout the delivery phase of the scheme on a phased draw down basis. The specific timing and interest terms will be determined at a later stage in the project. At this point, an average of drawdown 2 years prior to development is a reasonable assumption.

The key point is that a scheme of this scale will require phased land draw down. A number of phasing patterns can be modelled which have a relatively small impact on the overall viability. It is only when all the land is purchased upfront that this issue becomes significant, however, in our experience and that of Countryside, it is most unlikely that all the land will be purchased up front and it would not be appropriate therefore for the allocation's suitability to be determined on this assumption. It is more likely a form of Joint Venture partnership with the landowners, funders and developers is created to oversee delivery. The original landowner is likely to retain a ‘carried interest’ in addition to securing upfront payments for land that is drawn down.

We agree with Hyas that the viability shouldn’t be dependent upon land assembly given that a range of potential delivery models should be available to deliver the scheme.

8. In the 2019 Hyas VAU Grant scenarios:

(a) Is the value of the HIF funding accurately reflected in the adjustments made to the infrastructure costs, compared with the Reference scenarios?

No comment.

(b) Is it safe to assume that the HIF funding will not have to be repaid to the government?

No comment.

(c) What are the implications for the 2019 Hyas VAU of the reference to “recovery and recycling” of the HIF funding in the Business Case - HIF/FF/000365/BC/01 - Tendring Colchester Borders Garden Community [EXD/054], pp152-155?

No comment.

9. Is CAUSE’s critique of the 2019 Hyas VAU Inflation scenarios valid? (Section 10.0, pages 22-25 of CAUSE’s Consultation Response on EB086 Viability Assessment.)

No.

We remain sceptical that applying inflation assumptions will help to determine whether the scheme is viable. The model is very sensitive to inflation. We do not believe it is helpful or necessary to consider inflation in order to be satisfied the Plan is deliverable. On a scheme of this scale and length it is impossible to predict the course of inflation and modelling can demonstrate significantly different conclusions.

The scheme is considered viable based on today’s costs and values. It produces sufficient land value to incentivise land release and a healthy IRR. Countryside have confirmed this would be acceptable and allow a developer to proceed with the initial phases.

Both Hyas and Cause have commented on the different paths of build cost and house price inflation. The longer-term trend is for house price inflation to outstrip build cost inflation. Whilst they are currently running at a broadly similar level, the absence of inflation and any ‘placemaking premium’ in the present-day approach acts as a further contingency that the appraisals are not overly optimistic.

The application of inflation and potentially price premium for good design will be highly subjective. It will then require determining the appropriate discount rates and risks. This is a greenfield scheme in the East of England, only 50 miles from central London and within easy reach of Stansted, with strong interest from experienced developers. At this stage we don't believe the evidence suggests the scheme is high-risk.

Finally, it would be necessary to either discount the land value assumptions, where inflation is applied to other costs and values, or to inflate the land value.

10. (a) Should the 2019 Hyas VAU have applied a benchmark land value to each of the GCs?

No. The Local Plan is being considered holistically and the viability analysis at this stage cannot include full details. Given that all three sites are greenfield locations in reasonable proximity to one another, current existing use values are likely to be within range of each other. However, WofBGC is in our view in a better housing location. The approach taken, to assume a generic benchmark, above existing use value, and to consider the allocations at a strategic level is appropriate.

As further evidence emerges about each location, it may be necessary to adjust the appraisals to reflect local conditions and consider appropriate benchmarking. However, we do not believe the method adopted leads to the wrong conclusion. Greenfield land for housing development in this part of East of England is viable. This is due to the difference between achieved sales values and build costs. If it were not, then it is questionable whether it would be possible to demonstrate the viability of anything in most areas of the country.

(b) If so, what should the benchmark land value(s) be?

N/A

11. (a) Does any of the other viability appraisals submitted to the examination provide a more reliable assessment of the GCs' viability than the 2019 Hyas VAU?

We remain of the view that a simpler residual approach, as commonly adopted by the development industry, would provide greater clarity and be more reliable. Adopting inflation, as Hyas was asked to do, only confuses at this stage of assessment as it then leads to the next question of what level of discount rate should be applied to the cashflow.

Our own appraisal methodology is a reliable basis for assessment. In terms of ensuring risks are mitigated we would note

- Average Density of 38 Dwellings per hectare

- Inclusion of 10% contingency overall
- Developer's profit applied on 20% of value/25% of cost to the entire scheme
- 6% debit interest, 0.5% credit interest
- 300 dwellings per annum delivery rate

(b) If so, what are the key differences in the method(s) and inputs employed in that other appraisal which make it more reliable?

The main difference between our approach and that used by Hyas is a slightly more optimistic view on potential sales values. We believe demand is strong in the area, as Essex Highways/Jacobs acknowledge by stating "house building targets have regularly been exceeded"[1] and this scheme has the clear potential to provide high quality housing which can outperform the current second-hand market. Thus we believe our appraisal to be more reliable. Our marginally higher pricing tone has a significant impact on overall viability, however our general approach is in line with Hyas and that of other parties, supporting the view that the scheme is viable.

Word Count (Answers): [1539]

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[1] EB/079 Rapid Transport System for North Essex from Vision to Plan, Essex CC Highways & Jacobs, July 2019