6 September 2013
130906 Hertsmere Draft HBF Reps

CIL Consultation
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Hertsmere Borough Council
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**BY EMAIL ONLY**
**core.strategy@hertsmere.gov.uk**

Dear Sir/Madam,

**Hertsmere Borough Council CIL Draft Charging Schedule**
**Representation submitted on behalf of the Home Builders Federation and Members**

1.1 These representations are submitted in respect of the above, on behalf of the Home Builders Federation consortium, which comprises:

- The Home Builders Federation
- Barratt Developments Plc
- Bloor Homes Ltd
- Bovis Homes Group Plc
- Crest Nicholson
- Galliford Try Plc
- Gladedale Group Ltd
- McCarthy and Stone Retirement Lifestyles Ltd
- Persimmon Plc
- Redrow Plc
- Taylor Wimpey Plc
- The Miller Group Ltd

hereafter known as 'the Consortium'.

1.2 This representation has been submitted to influence the emerging Community Infrastructure Levy (CIL) Charging Schedule proposed by Hertsmere Borough Council (HBC). The representation is made in respect of the Draft Charging Schedule (DCS) published for public consultation in the period to September 2013. Our clients' particular comments relate to the proposed rates for residential development.

1.3 The Consortium has come together as a result of certain concerns with the approach proposed by HBC, notably regarding the viability of the proposed rates for residential development. The Consortium's members have land holdings across the HBC area which will likely contribute to the maintenance and delivery of the housing land supply (to meet identified housing needs). The rate of CIL is therefore of critical importance to our clients.

1.4 In submitting this representation, we have reviewed the response from HBC and Lambert Smith Hampton (LSH) to our representations submitted to the Preliminary Draft Charging Schedule (PDCS).

Offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

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The Consortium comments here on particular key areas of the evidence base and analysis, where our concerns voiced at the Preliminary Draft stage have not been addressed.

1.5 We have grouped our concerns into four key areas:

- Appropriate level of profit margin;
- The interpretation of the viability evidence in setting the proposed residential rate;
- The allowance for a 'Viability Cushion'; and
- The flexibility in the operation of CIL following adoption.

1.6 We will address these four areas in turn.

## 2.0 Profit Level

2.1 Within the Lambert Smith Hampton Stage 2 Viability Assessment, July 2013 (Stage 2 VA)[1], the discussion concludes that a 17% return on Gross Development Value (GDV) (20% on cost) is appropriate. We acknowledge that further consideration has been given to this by LSH in providing the updated VA. However, we do not agree that 17% on Gross Development Value (GDV) is sufficient. We reiterate below the points made in our representation submitted to the PDCS consultation.

2.2 In Savills experience of undertaking valuations for loan security purposes, the minimum profit margin that the lending institutions are currently prepared to accept, on residential development, is 20% on GDV. In recent months, the appeal decision relating to Land at The Manor, Shinfield, Reading has been made by the Planning Inspector.[2] We are of the opinion that this is an important case in terms of viability in planning, and whilst it is not directly related to CIL, it does address many of the factors that are under consideration here. In particular developer's profit. The decision states:

*"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%. Those that differentiated between market and affordable housing in their correspondence did not set different profit margins. Due to the level and nature of the supporting evidence, I give it great weight. 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."*

2.3 The aforementioned letters referred to are enclosed with this representation.

2.4 Of particular note is that there was no difference between the assumed profit on private and affordable housing. LSH have assumed only a 6% profit on affordable housing cost. The advice provided by the HCA is historic and originates from a time when grant funding was available and the risk of delivering affordable housing was much lower. We are now experiencing increased risk in the delivery of affordable housing and, indeed, have seen examples of house builders that have purchased land but who have failed to secure the interest of a Registered Provider to take on the affordable housing units. This increased risk warrants an appropriate level of market risk to be factored into the profit on the affordable housing. We therefore believe that, in accordance with the Inspector's decision noted above, no distinction should be made between the profit levels on affordable and private housing.

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[1] Paragraphs 5.2 – 5.6

[2] Ref: APP/X0360/A/12/2179141, 8 January 2013

2.5 We note that in the DCS Background Document,[3] comments are provided in response to our submission at PDCS stage in respect of profit. Much of the focus in the response is around the risk associated with construction and the impact this has on the selection of an appropriate profit margin. We would also add that risk of increased construction cost is not the only risk, indeed market risk is significant in any development in the current economic climate. It is market risk that is unaccounted for in the VA. As noted within the Background Document, construction risk is incorporated within the contingency sum.

2.6 We would stress that the minimum acceptable profit margin for the Consortium is therefore 20% <u>on GDV</u>. 20% on developer's costs is actually roughly equivalent to only 16.3% on GDV, which is significantly below the expectations of lenders. We therefore maintain that the profit margin is inadequate to cover all the associated risks of development and therefore does not represent an appropriate return to a willing developer.

## 3.0 Interpretation and Application of the Viability Appraisal Results

3.1 We understand that the VA has been a two stage process and that refinements have been made between the stages. The Stage 2 VA goes some way to explaining the refinements made between the two reports, however there are some unusual results that do not appear to follow the logic of the changes.

3.2 For example, within the Stage 2 VA, the report sets out the maximum CIL rates identified within the Stage 1 VA, which for the postcode are WD23 reached a maximum of £156/$m^2$ at a density of 100dph[4]. It discusses changes to assumptions for the purposes of the Stage 2 VA[5], including a reduction in the assumed sales value in the WD23 area from £416/$ft^2$ to £360/$ft^2$. The conclusion within the Stage 2 VA is that the WD23 area can now (at Stage 2) afford a proposed CIL rate of £210/$m^2$, having been covered by the generic proposed £120/$m^2$ at Stage 1.

3.3 Firstly, given the analysis presented above, we cannot see how a reduction in sales values of 14% justifies a 43% increase in the proposed CIL rate; this does not logically follow as reduced sales value would have a negative impact on viability. Secondly, if the maximum potential CIL within the WD23 area is £156/$m^2$, we cannot understand how this has changed into a CIL rate of £210/$m^2$ for the same area at Stage 2 – there is little explanation and the appraisal results for each viability appraisal have not been provided. Within the WD23 area, Bushey accounts for a fifth of the housing supply for the Borough, therefore any inaccuracy that would render development unviable in this area could seriously put at risk the delivery of the plan. There is therefore insufficient justification for this rate and we do not believe it to be appropriate. We are concerned that the other proposed rates are also undermined by similar inconsistencies and therefore request a thorough review and check of the assumptions, appraisals, results and proposed CIL rates across all areas.

3.4 We also note that within the table in the Stage 2 VA showing a summary of the Stage 1 and Stage 2 CIL outputs[6], the Stage 1 outputs appear to be exactly the same figures as the Stage 1 assumed average <u>sales rates</u>, albeit in £/$m^2$ not £/$ft^2$ respectively[7]. This appears to be a mistake as none of the results in the Stage 1 VA are above the lowest quoted figure of £345$m^2$.[8] This seriously misrepresents the work undertaken previously and the impact of the revised work undertaken at Stage 2. It implies that there has been a significant downward revision of rates through refinement, which there has not been. The proposed residential rate within the Stage 1 VA was £120/$m^2$; the maximum rate proposed in the DCS is £210/$m^2$.

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[3] Paragraphs 4.9 to 4.13, Hertsmere Borough Council, July 2013
[4] Paragraph 6.1
[5] Paragraph 5.16
[6] Paragraph 6.6
[7] Paragraph 5.16
[8] Paragraph 6.66, Stage 1 Viability Assessment, Lambert Smith Hampton, December 2012

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3.5 We are therefore highly concerned that there are errors in the data. We previously highlighted these at the PDCS consultation stage and are disappointed to have received no response on these particular points and for the evidence to therefore remain flawed. We request, again, that this is checked and, for transparency, the appraisal results are provided for consideration and Examination.

## 4.0 Viability Cushion

4.1 In addition to the comments above, it is best practice to apply a viability 'cushion' when setting the rate of CIL, in accordance with the Statutory CIL Guidance, published in April 2013, which states: ***"charging authorities should avoid setting a charge right up to the margin of economic viability across the vast majority of sites in their area."***[9]

4.2 In reality, site specific circumstances will mean that the economics of the development pipeline will vary from the typical levels identified via analysis of a theoretical typology. This is inevitable given the varied nature of housing land supply and costs associated with bringing forward development. Therefore, there must be a viability cushion incorporated either into the benchmark land value or elsewhere through the CIL assessment process which would ensure delivery of sufficient housing to meet strategic requirements.

4.3 The Examiner's Report for the Greater Norwich Development Partnership references the importance of not setting the CIL rates up to the margin of viability and therefore recommends the application of a 'Viability Cushion'.[10] This notes that there must be allowance within the CIL rates to account for the variation in landowner aspiration, as well as the potential differences in costs and values of individual sites. The viability cushion should take account of the risks to delivery flowing from the potential for some sites to achieve a lower sales value than others.

4.4 We acknowledge that further consideration has been given to the issue of a Viability Cushion in the revised July 2013 Stage 2 VA.[11] LSH set out their assumptions which they consider to include a Viability Cushion within them,[12] so as to provide flexibility and to '*minimise the potential for unviable development*'.[13] However, later in the VA[14], this 'flexibility' in the assumptions is reported to also be there to ensure that a net return of 17% on GDV '*remains reasonable'*. Whatever the Viability Cushion is that has been built into the assumptions, it appears to be serving two purposes. Without quantifying the Viability Cushion, it is not clear that the Viability Cushion is sufficient to make up for the deficiencies in the profit (as noted above) and to allow for the risk of movements in costs and values.

4.5 We therefore consider that it is <u>not</u> clear that the delivery of the Plan has not been put at risk.

## 5.0 Flexible Operation of CIL

5.1 Despite the narrow Regulatory requirements of the Examination, our clients urge HBC to make clear at the earliest opportunity the supporting documentation needed to operate CIL and to make it available for input/comment. Practically, this needs to be done prior to the Examination so that participants and stakeholders are able to comment on the effective operation of CIL. Whilst this supporting information is not tested at Examination, this information is critical to allow for the

[9] Paragraph 30, 2012
[10] Paragraph 25, 2013
[11] Paragraphs 4.31 to 4.33
[12] Ibid. Paragraph 4.33
[13] Ibid. Paragraph 4.31
[14] Ibid. Paragraph 5.4

successful implementation of CIL and to demonstrate that the CIL has been prepared positively and supports sustainable development.

5.2 The documentation should include:

- Guidance on how to calculate the relevant 'chargeable development'/level of CIL (cross referral to CLG guidance/Planning Portal – location of the Notice of Chargeable Development Form – further with regard to the RICS published guidance on Gross Internal Area – and what should be included).
- Guidance on liability to pay CIL/Appeals process.
- Policy for payments by instalments.
- Approach to payments in kind – notably valuation process for ascertaining land value and also the potential to accept land for infrastructure as a payment in kind.
- Guidance on relief from CIL and a policy on exceptional circumstances for relief from CIL.

*Relief*

5.3 The Community Infrastructure Levy Relief – Information Document (CLG, May 2011) outlines the Government's position on ***"exceptional circumstances"*** which could warrant exception from CIL[15]. The first matter to note from the CIL Regulations is that the offer of relief is discretionary on the charging authority[16]. It is also noted that HBC have declined to introduce this relief.[17]

5.4 The Consortium considers it imperative that HBC makes available relief from the date of the adoption of CIL, and that they clearly outline their approach to doing so (in conformity with the Regulations) so that there is no risk to the delivery of development unintentionally rendered unviable by CIL.

## 6.0 Conclusion

6.1 As discussed throughout this submission, we are concerned that the supporting evidence has significant inconsistencies within it and some of the assumptions within the viability appraisals do not appear to be justified of appropriate. The result of this is that we believe the evidence has not shown that the proposed CIL rates will not put at risk the delivery of the relevant Plan. HBC has selected to charge a rate at the absolute margin of viability, allowing no flexibility for site specific circumstances of viability. This is a high risk approach and is likely to be considered inappropriate by the Examiner, not least because it is not in accordance with Statutory Guidance nor is it in line with published Examiners' reports.

6.2 The Consortium is open to meeting with HBC and its advisors to discuss the approach taken and the required adjustments and refinements required to ensure that the rate proposed does not put at risk the delivery of the Plan. We believe this should be arranged as soon as possible.

6.3 In accordance with Regulation 21(1) we request the right to be heard by the Examiner, to be notified of the publication of the Examiner's recommendations and to be notified of the adoption of the CIL by HBC.

[15] Paragraph 66 onward
[16] Regulation 55(3) (a), Community Infrastructure Levy Regulations, 2010, as amended
[17] Paragraph 7.3, Community Infrastructure Levy Draft Charging Schedule Background Document, HBC, July 2013

Yours faithfully,

**For and on behalf of Savills (UK) Ltd**

M. Pritchett

**Melys Pritchett BSc (Hons) MRICS**
**Associate Director**

Enc. Letters relating to developer profit margins

# APPENDIX 13

## Developer Profit Margin Evidence

Mr Chris Newman
Haslams Chartered Surveyors
County House
17 Friar Street
Reading
Berkshire
RG1 1DB

Bellway Homes Limited
**Wessex**
Bellway House
Embankment Way
Castleman Business Centre
Ringwood
Hampshire
BH24 1EU

Telephone 01425 477 666
Fax 01425 476 774
DX 45710 Ringwood
www.bellway.co.uk

Private & Confidential

Dear Chris,

I refer to our conversation of Friday 25 May 2012.

I can confirm that it is entirely normal for Bellway Homes to seek to make an absolute minimum of 20% return on gross development value (the total of private sale and affordable housing revenues) when acquiring sites unconditionally with the benefit of a detailed planning consent. In circumstances where is site is being sold either with no planning permission or with an Outline Planning Permission then the profit margin is expected to be higher to offset the additional risk. There are further financial measures considered, such as ROCE and the maximum cash outlay, that effect the decision to purchase a site, but the gross profit margin is currently our key driver provided the other two measures are deemed reasonably satisfactory.

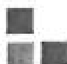
It should be noted that the 20% target is gross profit margin, ie before the deduction of finance costs, office overheads and selling costs which all vary from time to time and hence over the lifetime of a project, therefore the focus on gross profit margin as this is unaffected by outside influences.

Taxation is ignored in our project viability calculations and Divisional Profit & Loss accounts as this is dealt with at a PLC level.

Yours sincerely

Ian Blair
Land Director
**For and on behalf of**
**Bellway Homes Ltd (Wessex)**

Registered Office: Bellway Homes Limited, Seaton Burn House, Dudley Lane, Seaton Burn, Newcastle upon Tyne, NE13 6BE. Registered in England Number 670176
Bellway Homes Limited is a member of the Bellway p.l.c. Group of Companies



21st August 2012

Mr Chris Newman
Haslams Surveyors LLP
County House
17 Friar Street
Reading
Berkshire RG1 1DB

Dear Chris

Further to your recent correspondence, I write to advise that when assessing a development opportunity (either with a view to making an offer or deciding whether to proceed with a project), we are required to demonstrate that the site will generate a net profit margin (ie. after interest costs) equivalent to 20% of the total sales revenue (GDV) across the site. For the avoidance of doubt, in terms of the required profit margin, we do not differentiate between private and affordable housing; rather the site is assessed as a whole.

I trust that all of the above is clear but, should you require any clarification, please do not hesitate to contact me.

Yours sincerely

Andrew Lockwood
**AREA LAND DIRECTOR**

CALA Homes (South) Limited
CALA House 54 The Causeway Staines Surrey TW18 3AX T: 01784 225300 F: 01784 225301 www.calahomes.co.uk

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Institute of Customer Service

# BEWLEY
## HOMES PLC

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AJB/ljb/Misc/7040
5th September 2012

Mr C Newman
Haslams
County House
17 Friar Street
READING
Berkshire
RG1 1DB

Dear Chris

I refer to our recent correspondence with regard to the current returns that Bewley Homes look for when reviewing new opportunities on subject to planning sites or sites with the benefit of a planning consent.

You will be aware that there are a number of key indicators that will be reviewed when making the decision whether or not to buy a piece of land and the level of offer that we submit and the two indicators that are key to Bewley Homes are the gross profit and also the return on capital earned. The two indicators are never to be looked at in isolation, as one indicator will directly affect another, but in general terms the profit that Bewley Homes will need to see is a minimum of 20% but we are really looking to 25%. These profit levels would be increased normally on a larger sites of anything over 80 houses, as the return on capital would be dramatically affected by the length of time that the money has been employed and the time it will take for the returns to be received. Therefore on bigger sites, in order to reach our return on capital target of 20% to 25%, the profit margin normally needs to be in the region of 25% to 28% as a general rule of thumb.

I am aware that every different company has different key indicators and key targets and the profit margins that we look for are profit before interest and overhead. At the same time, it is evident from the competition that we have encountered in the past two to three years that most parties are looking for the same profit margins and that we probably look at the return on capital more than other companies.

I hope that the above clearly sets out our objectives and requirements but should you require any further information please do not hesitate to contact me.

Yours sincerely

**ANDREW BROOKS**
DIRECTOR

# Taylor Wimpey

Haslams
County House
17 Friar Street
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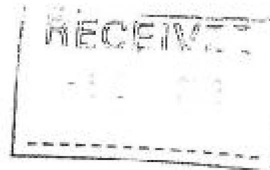


30th August 2012

Dear Chris,

**Re: Developers profit margin – Shinfield Area**

Dependant on the risk associated with the site, the location and deal structure, we would typically expect an average profit return in the region of 17% - 20% on the total GDV of the development.

In respect of a site of circa 150 units in Shinfield, we would expect an average profit return closer to 20% of the total GDV.

The above is the opinion of Taylor Wimpey West London and should not be relied upon other than in this circumstance.

Yours sincerely

**Andrew Moore**
**Land and Planning Director**

Taylor Wimpey UK Limited
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1392762 England and Wales.
Registered Office:
Gate House, Turnpike Road
High Wycombe, Buckinghamshire
HP12 3NR

Taylor Wimpey West London is a division of Taylor Wimpey UK Ltd

**Chris Newman**

**From:** Wild, Richard [mailto:richard.wild@dwh.co.uk]
**Sent:** 29 May 2012 09:48
**To:** Chris Newman
**Cc:** Palmer, Richard
**Subject:** RE: The Manor, Shinfield - Developer Profit Margins

Chris,

I refer to your below copied e-mail regarding developers' profit margins.

At Barratt / David Wilson Homes, we take into account not only a profit margin, but the return on capital employed. Furthermore, the profit margin required changes depending upon the risk factors involved. As we are still suffering the effects of the recession in that we cannot foresee a steady rate of sales over the next year or two, Group is adamant that margins must be protected.

To this extent, we have three profit margin targets, reflecting low, medium, and high risk categories. The level you have indicated of 20% of combined GDV is slightly lower than Group's minimum percentage margin for low risk sites, those being sites that have detailed planning permission, are fully serviced with no requirements for off-site improvements, have an agreement in place with a RP to take the affordable housing once it is built, etc. Each category of risk raises the margin by 1%.

We also seek deferred payment terms. Initially, this was resisted by land vendors, but many have come to appreciate that it is inequitable to expect a developer to pay a 10% deposit (we offer 5%), and to then pay the remaining 90% some 8 weeks later, before the developer has even set foot on site, let alone started to sell completed dwellings from which to fund the land purchase. For this reason, we seek to achieve legal completion about 8 weeks after exchange of contracts, but with a much reduced payment – possibly 20-25% - with a further payment after 6 months, etc. The length of deferral depends upon the size of site, of course, but we consider it reasonable to expect the land vendor to share our risk to a certain extent, and perhaps not receive their final payment until at least the first unit sale month. This deferral helps us to reduce the amount of cash we need to borrow in order to fund the land purchase and subsequent build, thereby reducing our funding costs. This saving, in turn, is then added back into the land value "pot" to help us be competitive when bidding for sites.

Our margin is based upon the whole site, such that we require the same margin for the affordable housing as we do for the private stock. I have never worked for a company that works on a lower margin for affordable housing, nor can I see any justification for doing so.

I hope the above is helpful, but please let me know if any clarification is required.

Regards,

Richard

The sender of this e-mail is a member of the Barratt Developments group of companies, the ultimate parent of which is Barratt Developments PLC (company number 00604574).

Barratt Developments PLC is registered in England and Wales with its registered office at Barratt House, Cartwright Way, Forest Business Park, Bardon Hill, Coalville, Leicestershire, LE67 1UF, together with its principal subsidiaries BDW Trading Limited (03018173), KingsOak Homes Limited (01993976), David Wilson Homes Limited (00830271) and Wilson Bowden Developments Limited (00948402). BDW East Scotland Limited (SC027535), also a principal subsidiary, is registered in Scotland and has its registered office at Blairton House Old Aberdeen Road, Balmedie, Aberdeenshire,

## Chris Newman

**From:** Regent, Jon <jon.regent@persimmonhomes.com>
**Sent:** 30 May 2012 19:12
**To:** Chris Newman
**Subject:** Developer's Profit Levels

Chris

Further to our recent conversation you have asked for a rough "indication" of the gross profit levels that are generally operated amongst the volume house builders.

Obviously this will change on a site by site basis, but on a typical site in the Reading area of circa 125 dwellings (with outline planning consent) with an on-site affordable housing provision we would need to demonstrate that a profit level in the order of 20% of the gross (combined private and affordable) development value would be achieved from the development.

I hope that the above is sufficient for your purposes but please do not hesitate to contact me if you require any further details.

Regards

Jon

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