The viability barrier

1 June 2016

Allison Blakeway examines the planning challenges faced by commercial developments in the regions

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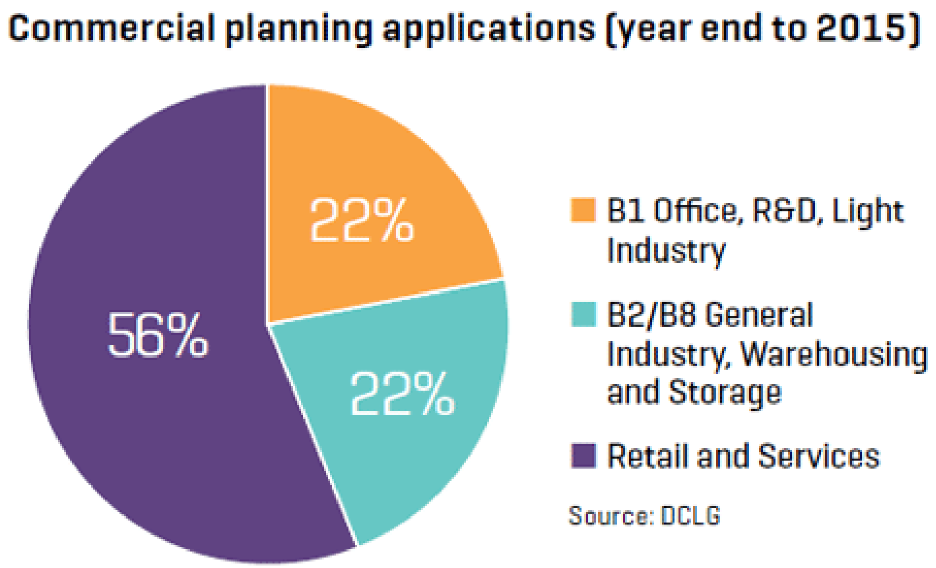
Economic growth is commonly held to be the lifeblood of the country?s future. The National Planning Policy Framework (NPPF) clearly encourages economic growth, and seeks to ensure it through development plan policy. In many parts of the country, however, finding suitable sites and premises remains a challenge, despite improving market conditions and supportive planning regimes.

Given the improvement in the economy and an increasing number of businesses seeking appropriate modern premises, one might expect developers to be beating a path to town halls to submit planning applications. Yet in reality, commercial development (B1, B2, B8, Retail and Services) applications nationally equated to just 3% of all decisions in the year to June 2015, according to statistics from the Department for Communities and Local Government (DCLG), with just over half of these relating to retail and service provision (not including mixed-use schemes, which are not defined), as seen in Figure 1. Figures for the year to June 2014 are similar. So what are the constraints, and why aren?t developers capitalising on the key opportunities that the economic recovery should present?

Figure 1



Insufficient return

Development viability is one of the main factors at play. Typical rental levels for many of the areas in which I work, mainly the Midlands and the North of England, are such that the economics of development just don?t stack up. Typical average values and costs, based on BCIS figures from November 2015, generate insufficient return for commercial developers to be confident about progressing speculative development, even without allowances for land purchase cost (see Table 1).

Not only do developers have to grapple with viability, there are usually other constraints. Brownfield sites often have ground conditions that require further attention. Planning policy also creates headaches; for example, meeting building standards such as BREEAM Very Good typically increases costs but does not generate additional value, despite the desirability of the environmental credentials that come with them. Re-using heritage assets generates additional costs in the form of retention and replacement of key features, but again a building?s appearance may only result in a small premium over existing rents.

Table 1: Typical rent/capital values and development costs (per m2)

	Industrial	**Office**	**Retail warehouse**
Rent	?110	?215	?110
Yield	10%	8%	7%
Capital value	?1,100	?2,687.50	?1,571.43
Construction	?977	?1,489	?1,046
Fees	?78.16	?119.12	?83.68
Marketing	?33.00	?80.63	?47.14
Finance	?65.29	?101.32	?70.61
Profit	?220	?537.50	?314.29
Total cost	?1,373.45	?2,327.57	?1,561.72

Obligations

Perhaps the most common market response is the introduction of other uses of higher-end value, which are often cited as necessary to secure development. However, the ability of local planning authorities to respond in an appropriate way may be restricted by limited understanding of the key issues and by policy wording.

In one of my recent cases, a long-term local plan allocation for commercial (B1, B2 and B8) uses was put forward, with the developer presenting a case for partial release of the site to enable residential development. In order for the scheme to be commercially viable, the developer argued that the normal planning obligations, affordable housing and education contributions would have to be negated. It also committed to provision of the commercial element first, despite pretty poor market conditions for the location.

The mandatory nature of CIL leaves no room for negotiation

The viability appraisal confirmed that the residential element could support the associated planning obligations in its own right. However, when considered in the wider context of the whole scheme, it still generated a loss. The local authority adopted a flexible approach in instances where residential viability would be compromised, but it argued that its policy made no provision for flexibility when considering enabling development. Hence, it dug in on negotiations, and consent was only granted with a full range of residential planning obligations. I doubt that bank funding for such a scheme could be obtained, and as a result, the prospects for delivery will be significantly undermined.

Another case in which I?m involved seeks to ensure that an urban golf club can remain financially sustainable by improving its clubhouse facilities thanks to the release of land for housing. Again, the supportive local authority has indicated that it will be willing to concede on section 106 obligations if the benefits for retained leisure uses can be demonstrated. A viability appraisal is required to show how that re-investment will work. There are no specific planning policies supporting this approach, even though the NPPF requires authorities to be flexible to ensure development can go ahead. There is a lack of certainty that those taking the decision will be so sympathetic.

Introducing higher-end uses could offer the potential to overcome the gap between cost and value. However, developers should not lose sight of the requirements to meet section 106 and Community Infrastructure Levy (CIL) obligations associated with the additional uses when such schemes are conceived. My own research on CIL rates in June 2015 revealed that, outside London, retail development is typically charged by 97% of all charging authorities with rates ranging between ?150/sq. m and ?350/sq. m. All charging authorities require residential CIL with rates typically up to ?200/sq. m. In addition, residential schemes will generate further requirements for affordable housing. While the introduction of higher-value uses into the scheme aims to improve viability, once the section 106 and CIL obligations are taken into account, it may still be problematic to make the scheme viable.

The mandatory nature of CIL leaves no room for negotiation, and while section 106 agreements offer greater room for flexibility, developers should be mindful of the local authority?s wording as to how flexible it is likely to be. The evidence base to support CIL charging schedules or section 106 provisions does not normally involve such situations being tested. Engaging with the developer during consultation stages may help to address this, but it?s unlikely that significant weight will be given to these types of scheme as they are largely considered to be one-offs.

Local development orders

Mixed-use schemes are not the only approach. Local development orders (LDOs) are now considered a key mechanism to help release sites for development, and many authorities will take opportunities to put these in place. However, while the LDO process may reduce the costs of a planning application ? and therefore overall fee payments ? and may make one site more attractive than another as a result, it does not reduce development costs or improve the potential for value. Their effectiveness in generating commercial development and making sufficient difference to the overall viability gap is still open to question. Consultation gives developers an ideal opportunity to inject market realism into this process, enabling the LDO to be more effective in the long term.

The challenging conditions for commercial development, in my view, clearly justify a return to supportive intervention by public-sector organisations. It is evident that grant regimes are a thing of the past, but the increased funding role of Local Enterprise Partnerships combined with the changing business rate environment at local authorities means that these organisations can operate in a more commercial manner, and also enables partnership working. Economic development strategies can be used to devise flexible programmes that support commercial development and thus economic growth. The involvement of private-sector developers in devising such programmes is, however, essential to ensure that the outcome is fit for purpose.

Ultimately, investment in new sites and premises will be required for a sustainable economic future. In many parts of the country, such growth is already stifled by a lack of sites and premises and the understandable reluctance of developers to take speculative risk. Market responses through mixed-use development may partially address the issue, but will not solve all the problems.

Collaboration

Delivery of commercial development under challenging market conditions cannot depend solely on the private sector. The public sector needs to consider ways in which it can establish effective collaborative partnerships and investment mechanisms that will enable commercial schemes. However, this requires a meeting of minds and a willingness to progress. Where this is achieved, economic growth can and will be secured for the benefit of all.

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Further information

- Related competencies include Development appraisals , Planning
- This feature is taken from the RICS *Property journal* (May/June 2016)