A report from Savills Research, sponsored by the Home Builders Federation

CIL – Getting it right

January 2014

Setting Community Infrastructure Levy Rates to Support the Construction of More New Homes

■ For local planning policies to be viable, there is a three way trade-off between the costs of CIL, Section 106 funding of infrastructure and affordable housing policy, with the costs of local standards and the move to zero carbon being additional costs to be factored into the trade-off.

■ Based on generic assumptions and before local specifics, the capacity to pay CIL and Section 106 on large greenfield sites equates to between 20% and 30% of unserviced land value in many markets. However, this capacity falls away towards zero where affordable housing policies apply at higher percentages in excess of 30%, and at lower percentages in markets in which potential sales values for volume sales are below £250 per sq.ft.

■ These are important markets, in which 85% of residential development outside London takes place. At sales values of £225 per sq.ft., in order for there to be enough 'in the pot' for CIL and Section 106 combined to be paid at £10,000 per plot, affordable housing policy would need to have been set at 10%. This is the trade-off that needs to be recognised when Local Plans are tested for their viability.

■ In stronger markets, there is more capacity to fund infrastructure via CIL and Section 106. At a sales value of £300 per sq.ft., with a 30% affordable housing policy, there is enough 'in the pot' for CIL and Section 106 to be paid at £15,000 per plot. However, this falls away to around £10,000 per plot if affordable housing policy is set at 40%.

■ The capacity to pay CIL varies widely, according to local policy on Section 106 payments. Even with scaled back Section 106 policy, the cost of Section 106 infrastructure is unlikely to be less than £3,000 per plot on large greenfield sites and it can often amount to significantly more than £10,000 per plot.

■ Viability testing of CIL cannot be robust if there is no clarity on Section 106 policy. From the other end of the lens, a zero CIL rate for strategic sites offers the greatest flexibility to use Section 106 to fund infrastructure and mitigate site impact, subject to the restrictions in the revised regulations.

Consistency is key

CIL is designed to contribute towards the funding of local infrastructure, to facilitate sustainable development. This is clearly a desirable outcome, provided the levy is set at a level that does not threaten the viability of the development plan.

Our objective in this report is to seek more consistency in the rate setting process, with particular regard to viability assessment, as the majority of authorities move towards implementation of CIL charging schedules. It is written with our experience of advising and representing members of the Home Builders Federation on appropriate rate setting at a local level across England and Wales.

Within this report, we review the rates at which CIL is being set by charging authorities across the country for the residential development of **large greenfield sites**, as these are such an important part of national housing land supply. Alongside this, we present a new benchmark for the capacity to pay CIL and Section 106 on such sites, based on a broad view on development economics, local market strength and affordable housing policy.

This paints a picture of the diverse approach that charging authorities are taking to the rate setting process. The result is wide variation in how authorities are striking the balance between fund raising and economic viability, in order to facilitate the scale of development outlined in their Local Plans.

What is the benchmark?

■ The benchmark is based on the residual development appraisal of a large greenfield site, with generic assumptions relating to significant variables. It gives a starting point for review of policy viability, before examination of local specifics.

How much CIL can be paid?

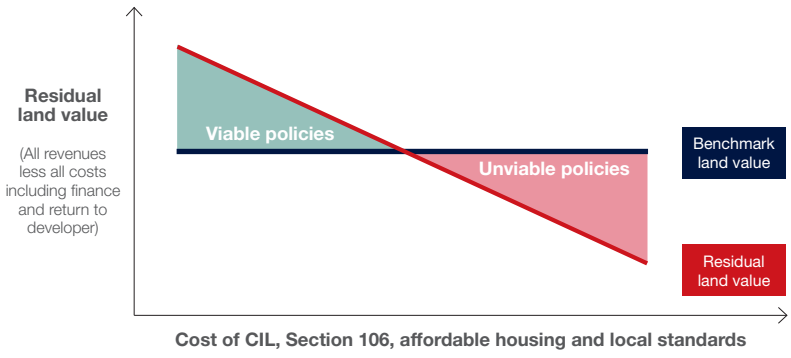
The National Planning Policy Framework requires that local planning policies should be tested for their viability, such that:

"The sites and the scale of development identified in the plan should not be subject to such a scale of obligations and policy burdens that their ability to be developed viably is threatened. 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." (para 173)

The costs of CIL and planning obligations are paid out of land value, as long as there is sufficient value remaining for the land to come forward for development (benchmark land value). If the residual value remaining (after deduction of all costs from total revenues) is too low, then the land is not economically viable to develop, as shown in Graph 1 below.

GRAPH 1

Cumulative impact of policy on financial viability



Source: Savills Research

> "It is rarely, if ever, the case that the pot of money is large enough to fund all policies"

The most crucial assumption in the policy testing process is the benchmark level of land value required to provide a competitive return to land owners, across the types of site that make up the housing land supply in the charging authority (usually the local authority area). This should be set at a level which includes a 'viability cushion', as recommended in the Local Housing Delivery Group guidance on the viability testing of local plans. When testing the viability of CIL, this reflects the government guidance that CIL should not be set at the margins of viability. This is particularly important for CIL, which is a fixed charge with no flexibility for variance, should individual sites be unviable.

The viability test will establish the pot of money that is available from development, to fund policies. It is rarely, if ever, the case that the pot of money is large enough to fund all policies, as the cost of delivering infrastructure is so substantial. If viability testing of the Local Plan and CIL is carried out concurrently, then the local authority can choose which policies take precedence.

However, if introduction of a CIL charging schedule follows the Local Plan, then the policies in the Plan must be costed fully in the testing of CIL. This includes affordable housing policy, Section 106 funding for infrastructure, any local standards that go beyond national standards and the additional known policy costs of moving towards zero carbon by 2016. In this case, CIL may be 'crowded out' by the cost of other policies.

How does viability vary across markets?

To take a view on the viability of policies across the country, we have developed a model for the viability of large greenfield sites in different strength markets. The output is a benchmark amount available to pay CIL, Section 106 infrastructure funding and the cost of local policies, taking account of affordable housing policy. It gives a starting point for review of policy viability, before examination of local specifics.

Table 1 shows the benchmark amount per plot, as an average across all tenures. This varies significantly, according to sales value and affordable housing policy, with little or no level of CIL being viable in lower value markets, where sales values are at £175 per sq.ft. In these markets, developers and local authorities need to work together to find ways of bringing sites forward, using policy flexibility and whatever public investment in infrastructure that can be made available.

Even in mid-priced markets there is a viability squeeze. For instance, at sales values of £225 per sq.ft., in order for there to be enough 'in the pot' for CIL and Section 106 combined to be paid at £10,000 per plot, affordable housing policy should be set at 10%.

In stronger markets, there is more capacity to fund policies. At a sales value of £300 per sq.ft., with a 30% affordable housing policy, there is enough in the pot for CIL and Section 106 to be paid at £15,000 per plot. However, this falls away to around £10,000 per plot if affordable housing policy is set at 40%. Viable amounts at lower affordable housing policies of 10% and 20% in higher value markets are greyed out in the tables, as such policies are unlikely to apply in these areas.

This is all based on generic assumptions relating to significant variables, such as the proportion of the site that is developable, the costs of site infrastructure and local land values. The specifics of the local market may differ from these generic assumptions.

If there is evidence of Section 106 payments having been agreed and paid at higher levels, then the specific circumstances of these sites should be understood, to test whether they are representative of the economics of the bulk of the land supply pipeline in the district.

TABLE 1

Amount available for CIL and S.106 (£ per plot, all tenures)

Affordable Housing %	Sales value per sq.ft.								
	350	325	300	275	250	225	200	175	150
0%	45,800	39,400	33,000	26,600	20,200	13,800	7,400	1,000	0
10%	38,300	32,700	27,100	21,500	15,900	10,200	4,600	0	0
20%	30,900	26,000	21,200	16,400	11,500	6,700	1,800	0	0
30%	23,400	19,400	15,300	11,300	7,200	3,100	0	0	0
40%	16,000	12,700	9,500	6,200	2,900	0	0	0	0
50%	8,600	6,100	3,600	1,100	0	0	0	0	0

Source: Savills Research

TABLE 2

Amount available for CIL and S.106 as % of unserviced land value

Affordable Housing %	Sales value per sq.ft.								
	350	325	300	275	250	225	200	175	150
0%	37%	37%	36%	35%	34%	31%	26%	8%	0%
10%	35%	35%	34%	33%	31%	28%	20%	0%	0%
20%	33%	32%	31%	30%	27%	22%	11%	0%	0%
30%	30%	29%	27%	25%	21%	14%	0%	0%	0%
40%	25%	23%	21%	18%	11%	0%	0%	0%	0%
50%	17%	15%	11%	5%	0%	0%	0%	0%	0%

Source: Savills Research

Land Value Capacity

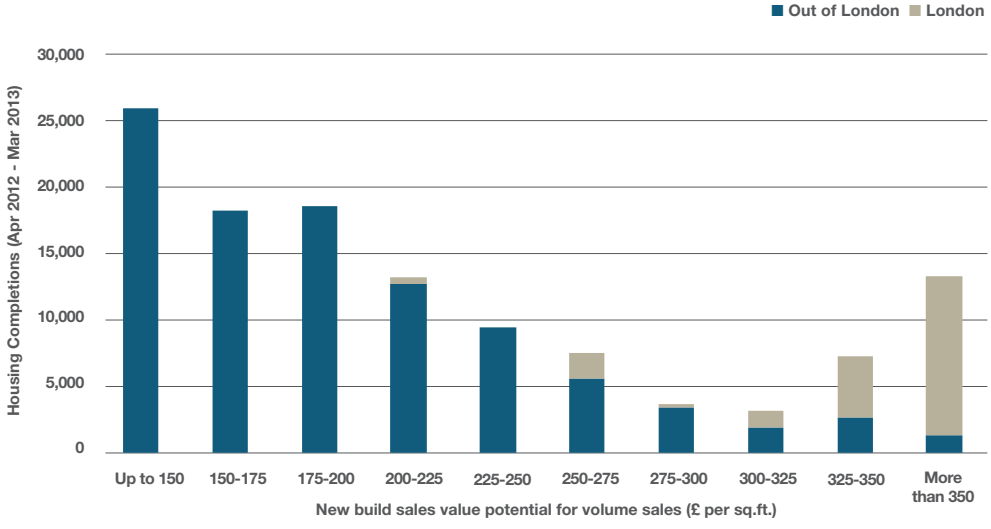
Expressing the benchmark as a proportion of land value gives a useful perspective on the capacity to pay CIL and Section 106. In higher value markets, the capacity to make the combined payment is between 20% and 30% of unserviced land value at 30% affordable housing, but this falls away towards zero at higher affordable housing policies in excess of 30%, particularly in markets where sales values are below £300 per sq.ft. (Table 2).

This is important, as more than 70% of residential development is in markets where new build sales value potential for volume sales is no more than £250 per sq.ft, as shown in Graph 2. Outside London, 85% of development is in these markets. Clearly, development does take place in these mid- to lower-value markets, generally on smaller sites that are less expensive to develop. Sales values on these smaller sites are not constrained by the competitive sales environment found on larger sites, so their viability can be supported by sales values that are higher than those achievable on the larger sites.

What is at issue here is the urgent need to bring forward large sites in areas where unmet housing need is greatest, as national housing need cannot be met without development of such sites. The analysis demonstrates there is only a limited potential to fund infrastructure from planning obligations and levies in markets where sales values are less than £250 per sq.ft. Many of the country's allocated greenfield sites are located in these markets, so other sources of infrastructure funding will be required here. It also indicates that allocation of more large greenfield sites in higher value markets would release more capacity to fund infrastructure from obligations and levies.

GRAPH 2

Housing completions in England, by volume new build sales value potential



Source: Savills Research Note: London sales values are shown for context only, as these are not relevant to the values achievable on greenfield sites

The Three Way Trade-Off

Section 106 payments are varying considerably in the emerging CIL world, depending on whether local policy is to scale back Section 106 alongside CIL, or whether significant site specific infrastructure will continue to be funded via Section 106. Some authorities have stated that Section 106 on large sites will be scaled back to amounts in the order of £3,000 per plot, to cover the amounts typically payable for smaller scale road and pedestrian connections, play parks and community buildings.

In other cases, major items of transport and education infrastructure will be funded via Section 106 on the large greenfield sites. At the East Cambridgeshire examination, a higher figure of £10,000 per plot was used as an assumption, but funding of such items of major infrastructure can exceed £15,000 per plot.

Whether Section 106 payments are nearer £3,000 or £15,000 per plot has a dramatic impact on the amount of CIL that is payable within our benchmark amount, as shown in

TABLE 3

Amount available for CIL – assuming £3,000 S.106 per plot (all tenures)

Affordable Housing %	Sales value per sq.ft.								
	350	325	300	275	250	225	200	175	150
0%	420	360	300	230	170	110	40	0	0
10%	390	330	270	200	140	80	20	0	0
20%	350	280	230	170	110	50	0	0	0
30%	290	230	170	120	60	0	0	0	0
40%	210	160	110	50	0	0	0	0	0
50%	110	60	10	0	0	0	0	0	0

£ per sq.m. of market housing

0%	11%	10%	9%	8%	6%	5%	2%	0%	0%
10%	10%	9%	8%	7%	5%	3%	1%	0%	0%
20%	9%	8%	7%	6%	4%	2%	0%	0%	0%
30%	8%	7%	5%	4%	2%	0%	0%	0%	0%
40%	6%	5%	3%	2%	0%	0%	0%	0%	0%
50%	3%	2%	0%	0%	0%	0%	0%	0%	0%

% of sales value

Source: Savills Research

TABLE 4

Amount available for CIL – assuming £15,000 S.106 per plot (all tenures)

Affordable Housing %	Sales value per sq.ft.								
	350	325	300	275	250	225	200	175	150
0%	300	240	180	110	50	0	0	0	0
10%	260	190	130	70	10	0	0	0	0
20%	200	140	80	20	0	0	0	0	0
30%	120	60	0	0	0	0	0	0	0
40%	20	0	0	0	0	0	0	0	0
50%	0	0	0	0	0	0	0	0	0

£ per sq.m. of market housing

0%	8%	7%	6%	4%	2%	0%	0%	0%	0%
10%	7%	5%	4%	2%	0%	0%	0%	0%	0%
20%	5%	4%	2%	1%	0%	0%	0%	0%	0%
30%	3%	2%	0%	0%	0%	0%	0%	0%	0%
40%	1%	0%	0%	0%	0%	0%	0%	0%	0%
50%	0%	0%	0%	0%	0%	0%	0%	0%	0%

% of sales value

Source: Savills Research

Tables 3 and 4. At the scaled back level of Section 106 of £3,000 per plot (Table 3), the viable level of CIL reaches £170 per sq.m. (around 5% of sales value) in higher value sales markets of £300 per sq.ft., at an affordable housing policy of 30%.

However, at the 40% affordable housing policy that often applies in such markets, this is squeezed to £110 per sq.m.

At higher levels of Section 106 of £15,000 per plot (Table 4), the capacity to pay CIL in addition is much lower, falling away to zero in most markets, other than the higher value markets in which sales values exceed £300 per sq.ft.

The revised CIL Guidance recognises the need for clarity on the interaction between CIL and Section 106, by formalising the need to be explicit on what is funded via each mechanism during the rate setting process.

As such, the so-called 'Regulation 123 list' of infrastructure is now part of the evidence base required during the rate setting process, although it is regrettable that the proposed requirements for formal consultation on any subsequent changes to this list have not been introduced.

Appraisal assumptions

The benchmark is the result of a residual development appraisal, adopting a standard set of assumptions which are shown in Table 5. Amongst these, the appraisal should allow for a competitive return to the developer. We use 20% margin on gross development value across all tenures, in line with evidence that this is a minimum requirement across the cycle.

The allowance for on-site infrastructure, at £20,000 per plot, is in the middle of the range of £17,000 to £23,000 per plot outlined in the Local Housing Delivery Group guidance.

The proportion of the site that is developable varies widely. We have assumed 50% of the site is developable for residential use, but this is often lower and can be as low as 30%, in which case the amount available to pay CIL and Section 106 will be lower than the CIL benchmark presented here.

TABLE 5

Assumptions summary

Net Dev Area (% gross area)	50%		
Interest rate	6.5%		
Marketing (% of sales)	3%		
Professional fees (% of build costs)	12%		
Additional build cost to 2013 Building Regulations (£ per dwelling)	1,000		
Infrastructure (£ per dwelling)	20,000		
Density (dwellings per acre)	14.2		
Dwelling size (sq.ft.)	1,030		
Coverage (sq.ft. per net dev acre)	14,600		
Developer profit on all GDV (excluding marketing and finance, to cover overheads)	20%		
Sales value (£ per sq.ft)	300	250	200
Affordable value as % of market value	43%	48%	55%
Build cost (£ per sq.ft)	97	91	86
Land value benchmark inc. buffer (£000 per gross acre)	290	190	95

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

Land Value and Viability Buffer

It is crucial to set a benchmark land value to represent a competitive return to land owners, such that the local land supply will continue to come forward for development.

Our benchmark appraisal uses a benchmark land value that includes a viability cushion. This has regard to both minimum land value and market land value, as shown in Graph 3.

Minimum land value represents the lower end of land owners' expectations of realisable value. It is a feature of option agreements between land owners and developers, representing the minimum value at which land will be released by the land owner to the developer.

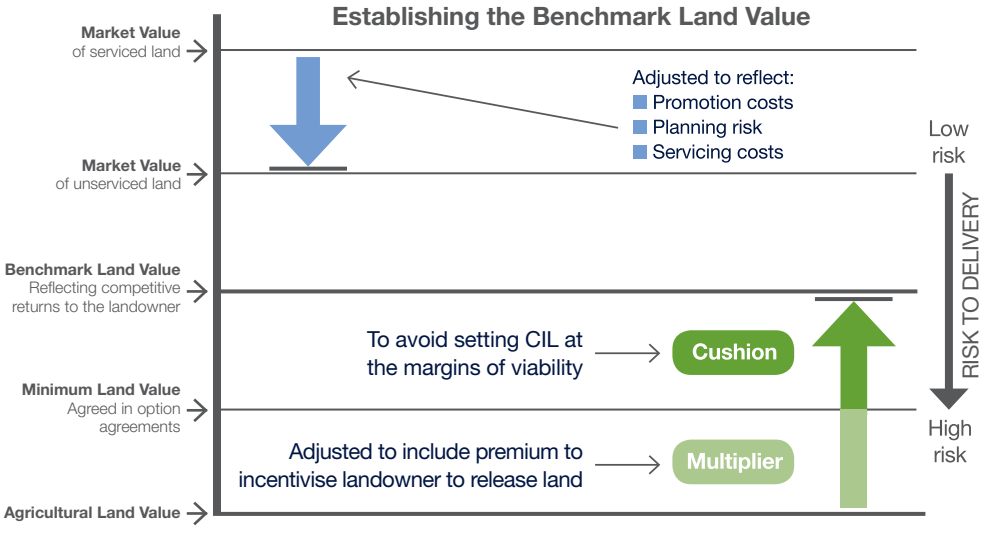
The Local Housing Delivery Group guidance recommends that evidence of minimum land values in option agreements is used as a reference point for setting a benchmark land value, subject to addition of a viability cushion, to include consideration of the costs and risks involved in promoting land through the planning system.

Market land value is, by definition, the value at which land will trade freely in the current system. If benchmark land value is set at the lowest end of the range between minimum and market land values, then high risks of non-delivery will be introduced into the development market.

Accordingly, we set the viability cushion at 50% of the gap between minimum land value and the market value of unserviced land (before considering deductions for CIL and Section 106).

GRAPH 3

Land value benchmarks and risks to delivery



Source: Savills Research

"It is crucial to set a benchmark land value to represent a competitive return to landowners"

Variation in approach to rate setting at local level

We have compared adopted and emerging CILs with our benchmark, in charging authorities where large greenfield sites form part of the housing land supply.

It can be seen in Graph 4 that many implemented CILs have been set at a level in excess of our benchmark, indicating a threat to delivery of the authority's development plan.

If this is the case, having taken account of local specifics, then the charging authority will have failed to demonstrate that they have struck an appropriate balance between the desirability of funding from CIL and its effects on the economic viability of development across the whole area, as now required by the latest amendments to the regulations.

Some of these early adopters did not appraise affordable housing policy at the full requirement that is shown in the chart. Following current practice at examination, an authority would now have to formally adopt a lower affordable housing requirement in order to set CIL at these levels. Graph 4 shows the increased headroom for CIL and Section 106 that is created by adopting a lower affordable housing requirement of either 10% or 20%.

In the one case where the benchmark sits above CIL in the chart, there is headroom for Section 106 in addition to CIL. In the case of Oxford, there is likely to be headroom for Section 106 to be paid at around £6,000 per plot in addition to CIL, according to the benchmark.

Charging authorities should be explicit about their policy intention on additional Section 106 when setting CIL rates. As noted above, such payments can be substantial on a large greenfield site, to mitigate the impact of development of that site. The need for clarity on this point has been emphasised by the forthcoming changes to the CIL Regulations.

The charging schedules that are at the examination stage (including those examined but not implemented) include fewer authorities where little or no CIL is viable at the adopted affordable housing policy (Graph 5). This is partly because there are fewer authorities within this group with relatively low sales values, which continue to hold back the viability of larger sites.

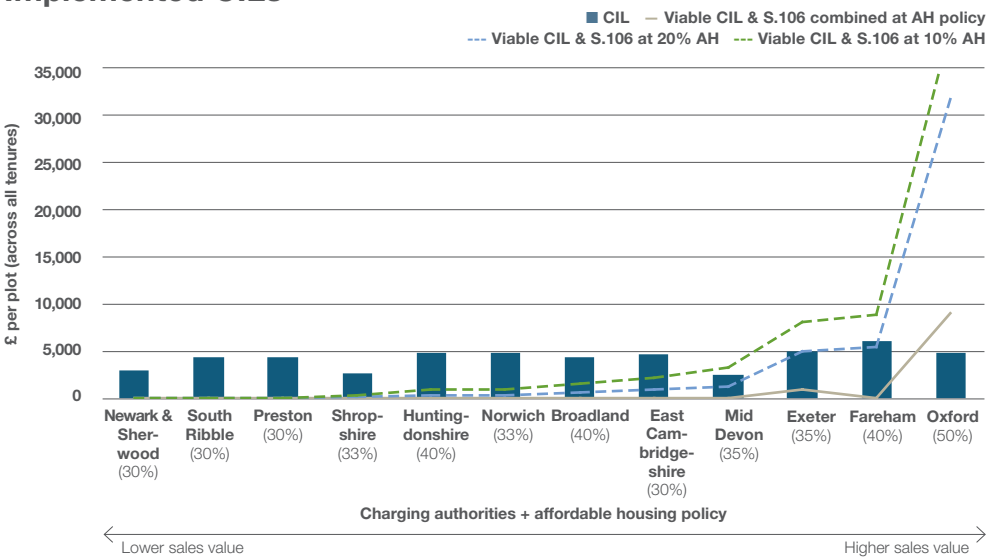
However, of these areas with CIL at examination, few have the headroom to pay a substantial amount of Section 106 in addition to CIL. Winchester is the exception, where there is likely to be headroom for Section 106 to be paid at around £10,000 per plot.

The Winchester headroom is a consequence of a zero rating of large greenfield sites for CIL, mindful of the benefits of creating flexibility for the Section 106 payment.

The contrast with the unviably high level of CIL proposed in Mid Sussex is stark. The same patterns have emerged amongst CILs at the draft (see Graph 6 overleaf) and preliminary draft charging schedule stages. ➔

GRAPH 4

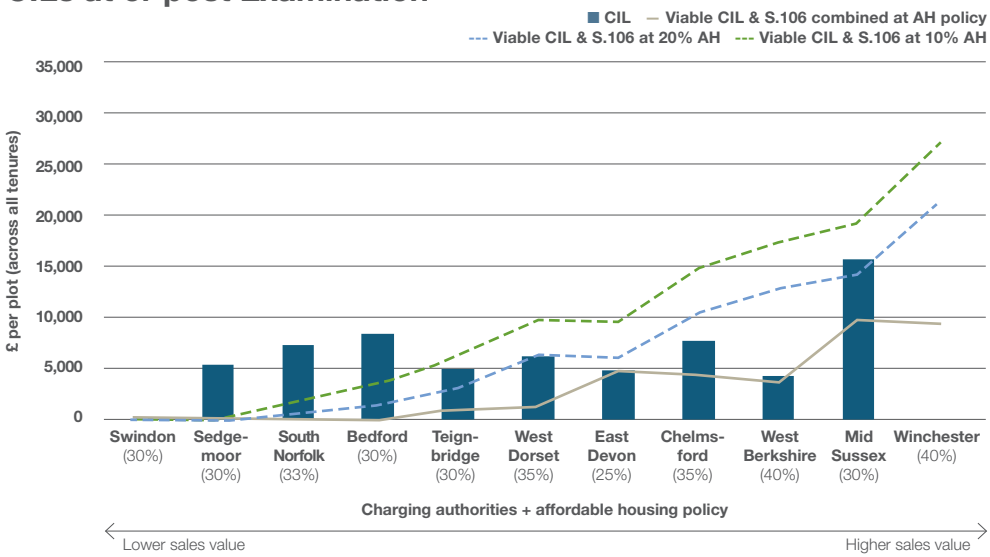
CIL and S.106 benchmark for large greenfield sites: Implemented CILs



Source: Savills Research (using Hometrack sales value data)

GRAPH 5

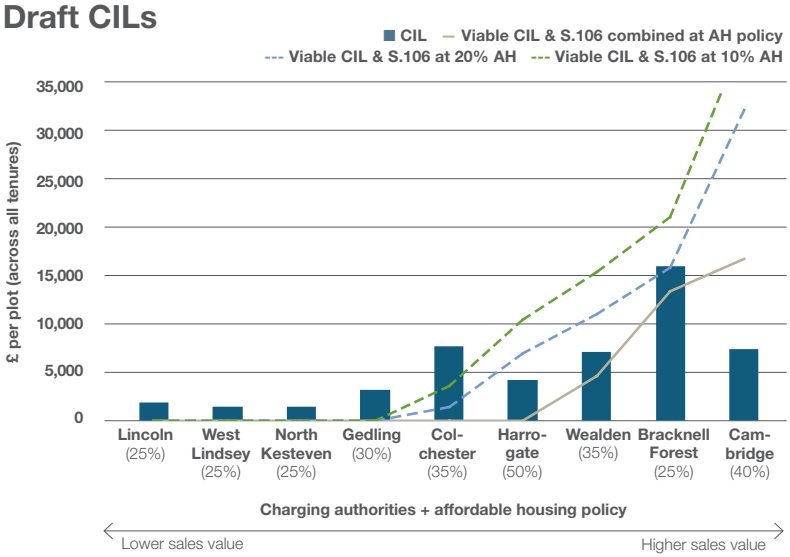
CIL and S.106 benchmark for large greenfield sites: CILs at or post Examination



Source: Savills Research (using Hometrack sales value data)

GRAPH 6

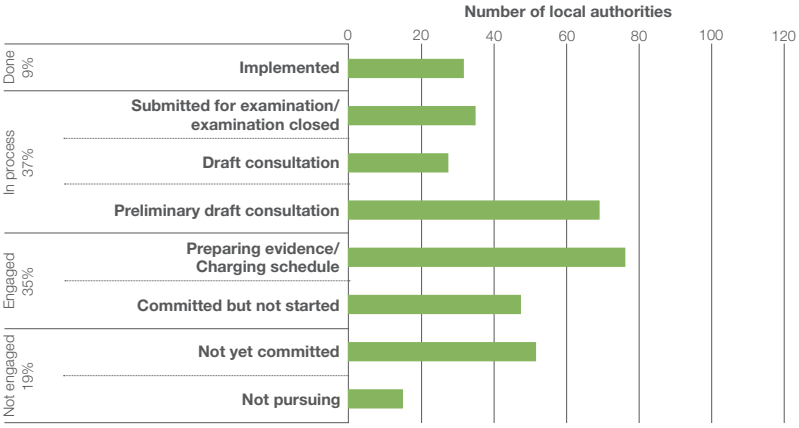
CIL and S.106 benchmark for large greenfield sites: Draft CILs



Source: Savills Research (using Hometrack sales value data)

GRAPH 7

Progress on CIL implementation (England & Wales)



Source: Savills Research (as at 20 January 2014)

"This exercise has revealed inconsistencies in the way in which setting of CIL viability is being approached across the country"

In these areas, affordable housing policy has been set at too high a level in mid- to lower-value markets for there to be any headroom for either CIL or Section 106. Whilst some authorities with draft schedules, such as Cambridge, have headroom for Section 106, others have proposed unviably high level of CIL. In the case of Bracknell Forest, the 25% affordable housing policy gives some room for CIL, compared with other authorities at 40% affordable housing. However, the proposed rate is unviably high, given the substanstial items of infrastructure that will be funded by Section 106, in addition to CIL.

More consistency needed

This benchmarking exercise has revealed inconsistencies in the way in which setting of CIL viability is being approached across the country. So far, only 31 CILs have been implemented, with a further 34 at examination (Graph 7). A large proportion (27%) of authorities are either at draft or preliminary draft consultation and a further 35% are engaged in the process at an earlier stage, so there remains scope for greater consistency in rate setting. Our intention is to seek such consistency in the rate setting process, as the majority of authorities move towards implementation of CIL charging schedules. ■

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