Matter 7 response December 2019

Viability

We welcome the opportunity to respond to the NEA Matter 7 hearing statement. We stand by our previous hearing statements and consultation responses, only commenting further where we have something distinctive to add.

General points

Level of evidence: The NEAs clearly feel they are being asked to provide too much detail. Thus they argue that a benchmark land value isn't needed, that they don't need to address corporate structure, and that they don't need to dig into the cost of capital.

The evidence provided needs to be proportional to their unprecedented ambition. The NEAs need to address the evidence of undeliverability presented both by objectors and planning history - there must be a reason why no new settlements of the proposed scale have been delivered since Milton Keynes. We draw attention to the attached chart from a December 2019 Lichfields report[1] which shows the disproportionate scale of the Essex proposals compared to smaller schemes which are making faster progress elsewhere. We question whether the chosen scale is deliverable.

Promoter appraisals: there are signs that the NEAs are relying on evidence from promoter appraisals to support viability. These appraisals have not been tested against the policies of the Plan and cannot be relied upon as evidence. In particular their infrastructure assumptions are much too low and late for sustainable development. We fear that promoter optimism will continue until the land is allocated, at which point the NEAs will be in a weak negotiating position.

Question 2 on Infrastructure provision

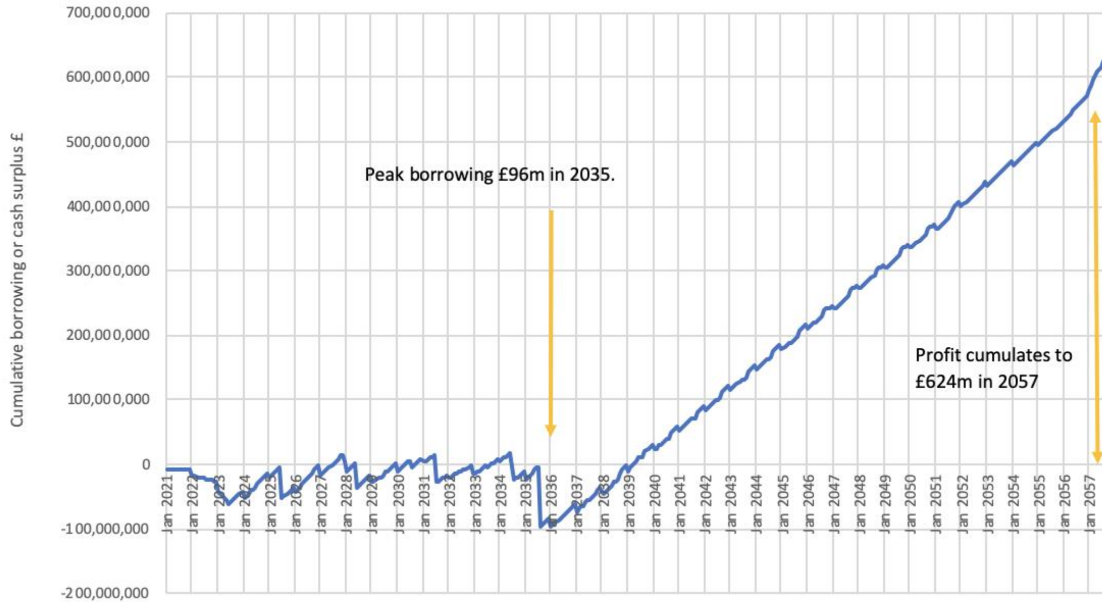
The NEAs state (para 7.2.7) that CAUSE does not repeat its original concerns over infrastructure provision. We stand by our 2017 consultation response which suggests that an infrastructure budget of £1.84billion is needed for West Tey alone. And we draw attention to our summer response and Matter 6 hearing statement which address specific shortcomings on roads, rail, healthcare, water, sewage and rapid transit.

We believe that the NEAs have significantly underestimated the infrastructure cost of building a standalone garden community. They should not be influenced by promoters, who understandably seek to minimise up-front investment. They are embarking upon a complex infrastructure project and need to be realistic about what they can achieve.

To illustrate our point on late infrastructure provision, we show a graph of the cash flows in one promoter's submission – there are similar patterns in the others. There is very little up-

[1] How does your Garden Grow, Lichfields, December 2019. "A stock take on planning for the Government's garden Communities programme.

front investment in the early years and significant profits at the end which look disproportionate compared to the risk taken.



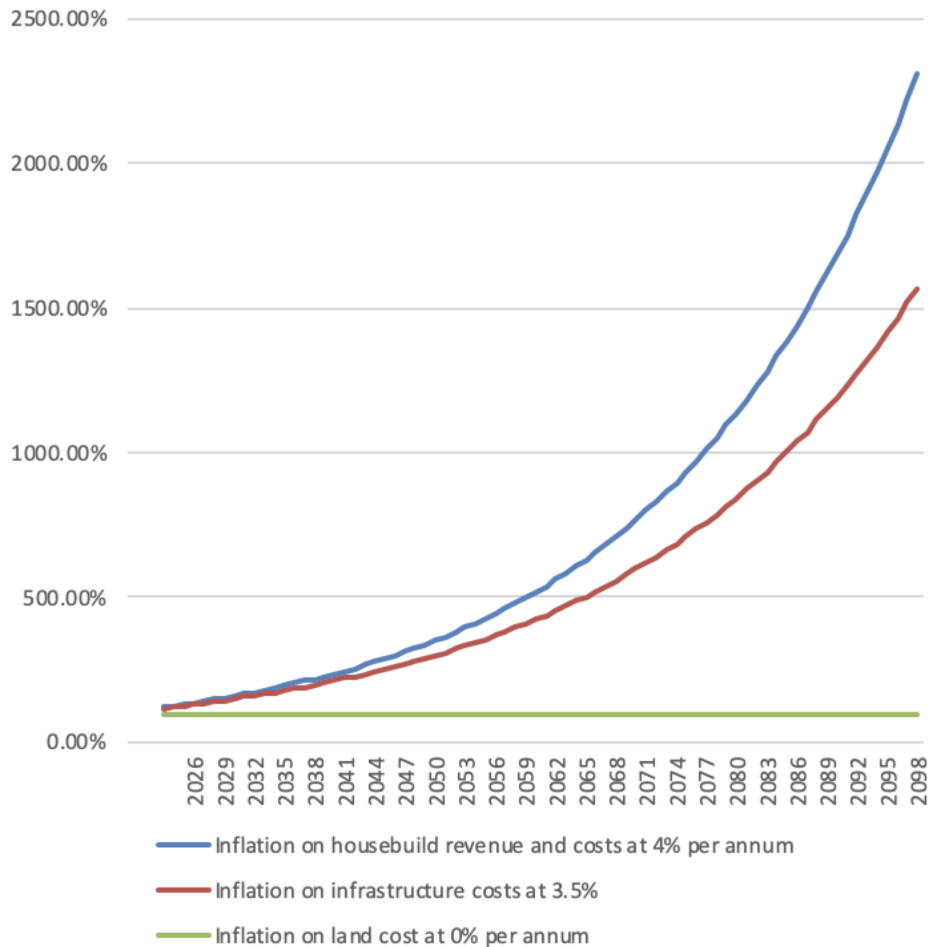
Question 7.3i – proportions of affordable rented and intermediate housing
We are alarmed by the admission in Para 7.3i.3 that the Plans do not define a specific tenure split for affordable housing. Social housing promises must be hard wired into the plan because otherwise they will be broken. Note that a supposedly 'technical' shift[2] in the affordable housing assumption between Hyas 2017 and Hyas 2019 produced a £153million[3] increase in residual value for CBB which was invisible to Councillors.

Question 3 – use of inflation rates (7.3j)

We stand by our statement that the Hyas inflation scenarios are so misleading that they should be publicly withdrawn. We add just one diagram to illustrate our point.

[2] The technical shift is explained in para 7.3i.1 of the NEA hearing statement. NPPF para 64 requires that 10% of large sites should be low cost home ownership products. This the reason given by Hyas for increasing intermediate ownership from 20% to 40%.

[3] See page 26 of chapter 3 of the CAUSE consultation response. This arose because intermediate housing is valued at 80% of the open market price whereas affordable rented is only 50% and the proportion of affordable rent was reduced.



The graph shows the impact of the Hyas inflation assumptions. Land is somehow bought at a fixed price spread over 80 years while house prices and build costs rise by 2300% - a wild assumption because landowners would surely never commit to a fixed price without indexation over an 80-year period.

The NEAs admit to this in para 7.9.3 saying that the "values could be profiled differently to reflect lower values earlier and high later during the full project period". But unfortunately the damage is already done: Councillors have already made unsound decisions based on overstated flat line land prices. Even Hyas fell into the trap when they indicated that grant funding was not needed in the inflation scenarios. This sort of modelling needs to be withdrawn and replaced with an NPV analysis with realistic assumptions about how markets operate.

7.3j.7 The NEAs say that "Historically property value growth has outpaced cost inflation by a considerable margin". Their evidence has been drawn from a period of continuous falls in real interest rates which has resulted in historically high house price / income ratios. It is

irresponsible to project such a trend forward showing a likely increase in the ratio from 9x (now[4]) to perhaps 19x (in 2098).

The NEAs need to take a more holistic approach to inflation if they are to model it sensibly. In the short term (in Keynesian language) big profits can be made while inflationary expectations adjust and this is what has been 'sold' to Councillors. However, over the Keynesian long term, which certainly applies here, it must be recognised that markets and government will react, and imbalances in the economy will be corrected. Land prices will rise as will interest rates.

7.3j.9 There is no inconsistency between CAUSE's views on inflation rates in 2017 and 2019. We have always argued that the Bank of England 2% target rate should be the starting point, and that deviations from that should only be included where is a sound economic rationale for doing so. There is nothing wrong with assuming that government policy achieves its objectives, at least as a sensitivity, and this is what we have done by suggesting a scenario where house prices rise at 1.25% alongside a general inflation rate of 2%.

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

The NEAs argue (para 7.4.8) for low contingencies based on other strategic sites where the project definition is significantly further advanced. The CBRE appraisal for Welborne for example was prepared to support a full planning application whereas the North Essex GCs are at conceptual engineering stage at best. Contingency might sensibly fall as the GC projects advance as follows:

Class 4 Estimate:	Conceptual Engineering finished	40-50%
Class 3 Estimate:	Preliminary Engineering finished	30%
Class 2 Estimate:	Front End Engineering finished	20%
Class 1 Estimate:	Detailed Engineering finished	10%

This reducing contingency approach is in line with HM Treasury's supplementary green book guidance[5] which emphasises the need to consider optimism bias and suggests a figure of 66% for non-standard civil engineering projects at the "outline business case" stage, reducing to as little as 6% at contract award.

It would be inappropriate to use the contingency levels seen in normal housing plans. We have consistently argued that we are looking at something quite different – a complex long-term infrastructure project – and this is how providers of finance will see it. 80 years is a quite different to the more normal 10-15 years and this alone should justify a different approach to contingency.

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[4] See ONS data supporting the formula for calculating housing need. House price / income ratios for Essex are 8.6x when residence based and 9.9x when workplace based. "Ratio of house price to workplace-based earnings (lower quartile and median), 1997 to 2016."

[5]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191507/Optimism_bias.pdf

We draw attention to page 80 of our 2017 consultation response which quoted precedents from Network rail (60% uplift for risk), HS2 in 2012 (39% contingency which subsequently proved to be too low), A120 dualling options in 2017 (44% contingency) and the Lower Thames Crossing (170% cost escalation between 2013 and 2016).

We also draw attention to Steve Johnson's expert evidence on the RTS system which suggests that realistic costings would triple the budget.

Question 5 – 6% cost of capital

The NEAs justify their choice of 6% by quoting from promoter appraisals[6]. But they have nowhere produced evidence from the financial markets to show that any market economic operator would provide 100% debt funding at that rate in practice.

NEGC's soft market testing[7] with pension funds cannot be relied upon. We know[8] that pension fund investors will look for recurring cash flows to hedge their annuity obligations, and that they will seek higher returns if they are to rely on the irregular cash flows associated with plot sales to housebuilders. It would be easy to obtain a generalised interest, but much more difficult to get a binding term sheet. If NEGC's views are to be believed they need to be supported by evidence that the investors have fully understood the risks.

If Homes England funding is to be used it will have to be on MEOP terms, so again we need market evidence, not second-hand reports of general discussions.

NEGC suggest[9] that public sector leadership will support a lower funding rate. This is a double-edged sword – public sector leadership is associated with slow decision making, lengthy procurement processes and political risk, and many investors will steer clear. Those who don't will be looking for legally binding guarantees (which must on MEOP terms) rather than vague reassurances.

Thus NEGC's view that a public sector led master developer will be able to achieve a lower funding rate is commercially questionable. If their view is correct they will be sailing too close to the state aid rules for comfort.

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[6] NEA answer to Matter 7 question 5.
[7] NEGC answer to Matter 5 Question 8
[8]This understanding of institutional investor appetite for development risk comes from the author's experience dealing with UK investors such Legal & General, Aviva, Hermes, U & I plc and US investors such as Neuberger & Berman, Berkshire Capital and CALPERS, whilst working at Partnerships UK, a spin off from HM Treasury engaged in advising on public private partnerships, and Capital & Regional PLC.
[9] NEGC Matter 7 hearing statement, answer to question 5

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Attachment – extract from Nathaniel Lichfield Partners Report December 2019 illustrating the unprecedented scale of Garden Community activity in Essex

Figure 6: Status of Garden Community projects and homes

South Seaham
Biggleswade
West Carclaze
Tresham
Halsnead
Handforth
Longcross
Eynsham
St George's Barracks
Berinsfield
Burtree
Dunsfold Park
Threemilestone
Cyber Central
Borough Green Gardens
Infinity
West of Elvington
Whetstone Pastures
Bailrigg
Long Marston
Spitalgate Heath
South Godstone
Dunton Hills
Dalton Barracks
Skerningham
Shapley Heath
Culm
Welborne
Newton Abbot
North Dorchester
Chilmington
North East Chelmford
Meecebrooke
Otterpool Park
Basingstoke
Tewkesbury Ashchurch
St Cutberts
Hemel
Bicester
Taunton
Didcot
Grazeley
Ebbsfleet
Aylesbury
Uttlesford
Exeter
Harlow & Gilston
North Northamptonshire
North Essex

0
10,000
20,000
30,000
40,000
50,000

Units

Completions
Outline permission
Adopted locan plan allocation
Emerging local plan allocation
No formal planning status

The Avison Young viability report 30/9/2019
A commentary by CAUSE

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NEGC's Consultation Response on Viability

CAUSE commentary on Avison Young report
9th December 2019

Summary

The Avison Young report claims to demonstrate that the GC plan is financially viable by utilising an "LLDC" structure[1]. But it actually achieves almost exactly the opposite. In particular:

- Its output (IRR) is potentially better[2] than the Hyas approach to evaluating long term projects, but IRR must be compared to the whole cost of capital, not just the cost of debt.

- Its new input (CPO land values) is opaque. The report from AY's CPO team needs to be made public. Furthermore, there would need to be careful testing around key assumptions underlying the CPO analysis (e.g. with regard to the important input of potential for alternative development, where using the Dentons advice in EB084 the whole report is premised on input from the NEAs which of course is not appropriately objective given their potential direct commercial involvement).

- Cost of Capital is a vital topic which Avison Young have surprisingly failed to address. The cost of debt used explicitly reflects government support, but an LLDC would be no less problematic a structure than any other for State Aid (see CAUSE Matter 5 Hearing Statement). The cost of capital must also reflect the cost of equity or any equity-like component of structure such as a guarantee. Even if an LLDC is borrowing from government (albeit at MEOP rates for State Aid compliance), it would need to be the case either that those MEOP rates reflect a 100% Debt structure (which would increase the MEOP interest rates significantly) or there would potentially need to be an equity component to reduce the risk profile ascribed to the borrowing. Note in this context that current legislation requires LLDCs to demonstrate a suitable return to justify borrowing, which is clearly an Equity-type concept.

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[1] Locally Led new town Development Corporation as per Avison Young para 11.

[2] It is better than the Hyas IRR calculation which is simply a circular reference to the inputted cost of debt, plus an adjustment for master developer profit; it is also potentially better than the residual value approach which here risks comparing future values with present ones for projects which have relatively unique characteristics of the land not being owned upfront. We have also seen examples of professional firms (Hyas in 2017, Gerald Eve and Troy Three Dragons) omitting interest on land costs despite specific warnings in the Harman guidelines; this error is not made in the Avison Young analysis, **but the cost of debt used appears to be far too low**.

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- It falls into similar (or indeed larger) traps on contingencies, delivery rates and inflation as Hyas. All of these items have a huge impact on viability because the economics are very sensitive to the size of the early phase infrastructure costs. Like Hyas, Avison Young provide no meaningful sensitivities which attempt to address the potential risk profile underlying these large, long-term projects which utilise virtually unprecedented structures.

- The words are inconsistent with the numbers and the conclusions are therefore not to be relied upon. We would like to see Grant Thornton's conclusions from the same numbers, with a comparison to those in the redacted part of the important December 2016 PWC report[3]

- The report concludes that the Garden Communities are viable and deliverable, but the numbers show exactly the opposite. The table below lists the Avison Young IRRs: we mark anything below 10% + inflation as red - unviable. Results marked amber are at the "margins of viability" and should not be assumed to be deliverable[4]. Only IRRs of 3% above the threshold should be marked green as viable and therefore deliverable. Our choice of these thresholds is explained below.

Avison Young IRRs compared to threshold

	Threshold based on PWC report	WOB	CBB	TCB
300 DPA no inflation	10.0%	5.39%	3.59%	8.20%
300 DPA 0.5% inflation	10.5%	6.90%	5.30%	10.00%
300 DPA 1% inflation	11.0%	8.37%	6.81%	11.65%
500 DPA no inflation	10.0%	8.00%	1.70%	10.30%
500 DPA 0.5% inflation	10.5%	10.30%	1.09%	12.57%
500 DPA 1% inflation	11.0%	12.55%	5.50%	14.74%

Note: These IRRs are based on the AY assumptions which we regard as too optimistic by far, particularly on contingency and land purchases. We have no doubt that all cases would turn red if realistic assumptions (indeed those prescribed by the Inspector) were included in just these two areas.

[3] We know that there are appraisal numbers in the PWC report because some Councillors have been allowed to see it.

[4] Harman Guidance page 16 "Given the clear emphasis on deliverability within the NPPF, Local Plan policies should not be predicated on the assumption that the development upon which the plan relies will come forward at the 'margins of viability". .

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1. Choice of IRR Threshold

Avison Young have not explicitly discussed the cost of capital or defined a viability IRR threshold. There is merely a suggestion in para 33 (accompanied by a very problematic statement re State Aid, on which see below) that the cost of finance is 2.5% for land, 5% for the cost of the LLDC until refinanced through the infrastructure loan at 3.5%. They seem to have leapt from that to the conclusion that all modelled cases are viable. We do not agree with this.

Two reports[5] provide support for a much higher IRR viability threshold:

1. The 2016 PWC report, which points out that the cost of capital must include not just the cost of debt but also the cost of equity or guarantee fees charged on an arms-length basis. With no guarantee the cost of debt would carry a margin of up to 10%[6] which has to be added to a base rate. This figure should, in financial theory[7], stay at the same level for different capital structures whether the level of debt is high or low, and whether the equity risk is born by a guarantor charging a guarantee fee or an equity investor expecting income and capital growth.

2. The CBRE report[8] prepared for Fareham Borough Council for Welborne Garden Village which states on page 25 that *"On strategic sites a key measure of viability is the IRR which should, ideally be, circa 12%+."*

We suggest that a minimum viability threshold of 10% + inflation[9] should be adopted, at least until a proper WACC study has been done[10]. Given inflation expectations at around the BoE 2% guideline, this is broadly in line[11] with both the PWC report and CBRE's estimate.

Anything just above the minimum should be regarded as at the "margins of viability", and, as per the Harman guidance, should not be considered viable in a Local Plan context. Indeed, we suggest that anything within 3% of the minimum is "at the margins of viability", while anything above is potentially viable.

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[5] Further evidence is provided by the Uraban & Civic s106 agreement for Alconbury where a 20% IRR is the threshold for increasing the social housing percentage above 12.5%. 20% is clearly regarded as an acceptable return for the master developer.

[6] See PWC report 16 December 2016 page 23

[7] We are aware that some capital structures are more tax efficient than others. but all the viability work on GCs today ignores tax issues and for the time being we do too.

[8] https://moderngov.fareham.gov.uk/documents/s23065/Appendix%20B%20-%20Welborne%20Viability%20Review%20-%20Edited.pdf

[9] AY agree that inflation should be added – see para 12 "In such cases the target IRR is increased to account for the level of growth/inflation being applied."

[10] A proper Weighted Average Cost of Capital study might be based on the Capital Asset Pricing Model, starting with the risk-free rate and pricing in risk premia at market rates.

[11] The threshold including 1% inflation is 11% which is very close to the PWC figure of 10.75% including .75% base rate or 20 year swap rate.

2. State Aid Implications for Finance Rates / Cost of Capital

The PWC report makes it clear that the funding of any delivery vehicle must be on arms-length terms otherwise there may be illegal state aid. The MEOP[12] principle means that a public body cannot provide soft loans to such a vehicle: it must show that a commercial bank or other market investor would have provided the cash on the same terms. Equally it cannot guarantee loans without charging the same guarantee fees as a commercial bank. If the public body wants to provide equity finance, then the terms need to reflect the cost of market equity including the prospects of income and capital growth.

Avison Young ignore these economic 'facts of life' (despite presumably having access to the PWC report), saying in para 33 that. *"The finance rates adopted by Grant Thornton are in line with the rates that are used for projects to be carried out by state enterprises such as a LLDC".* No bank would lend to a newly-formed SPV with no trading history and no regular cash flows at 2.5% interest rate **without a guarantee**. They have ignored the cost of the guarantee and the warnings in the PWC report, which point to a much higher cost of capital.

This has relevance for the potential IRR thresholds (on which see above) but also means that the finance rates used in the viability modelling are incorrect.

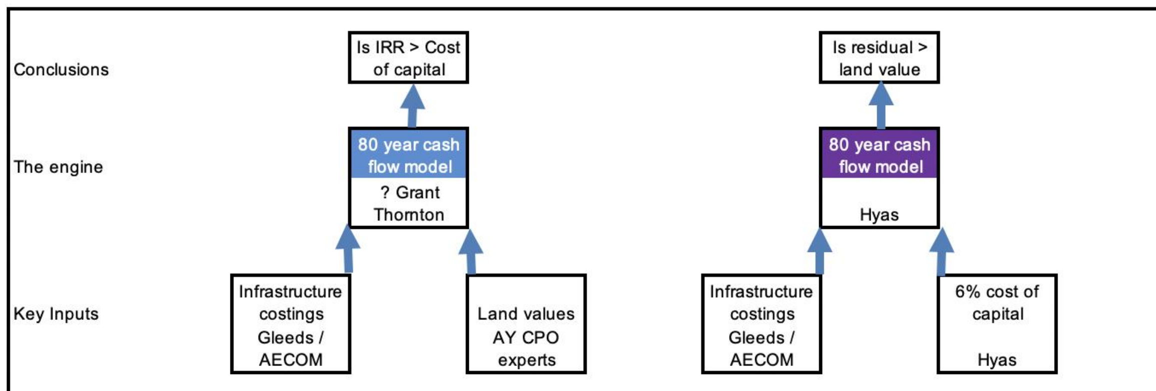
3. Other Evaluation Metrics

AY claim to have produced outputs other than IRR. We consider them below.

2.	In line with the approach adopted by both Hyas and Troy and the requirements of PPG, our viability assessments assess whether the value generated by each of the developments exceeds the cost of developing it, to include the value of the land required for the development and the infrastructure, and it measures the return as a net present value showing the internal rate of return.

NPV: para 2 (reproduced in box above) suggests that there is an NPV analysis, but word searches shows that there is none in this report. If the work has been done as claimed it certainly hasn't been published. NPV analysis is rather different from IRR analysis as illustrated in the diagram below:

[12] MEOP = Market Economy Operator Principle



Profit as % of Gross Development Value: AY have provided profit / cost figures but they are not comparable to industry norms of 20-25%,[13] for three reasons:

a. AV uses profit / cost rather than the industry norm of profit / GDV;
b. Most industry appraisals cover build periods of < 10 years, not up to 80 years;
c. The finance charge is much lower than the industry norm of 6.5%-7.5%. The 2.5-5% rates used by AY (see para 33) render profit comparisons meaningless.

4. Corporate Structure

There is still ambiguity around the proposed delivery structure, and a tendency to "cherry pick" benefits from certain models to improve viability results. For example in para 11, we are told clearly that the delivery vehicle will engage in market activities.

> 11. We have undertaken testing adopting a model that assumes that NEGC becomes a locally led development corporation (" LLDC") possibly in combination with a Local Delivery Vehicle (1) manages the proposed development through the process for consent (2) funds and installs necessary infrastructure such as roads and ser vices (3) funds and meets the cost of the social and community benefits (4) sets up and ensures funding for the long term stewardship of the development and (5) manages the disposal of serviced land to end developers. It should also be noted that a LLDC should be able to deliver a Local Development Order earlier than the Hyas model assumes can be delivered.

But in para 33 we are given interest rates that could only be achieved with a public sector guarantee for which there is no charge: this comprises illegal state aid.

> 33. The finance rates adopted by Grant Thornton are in line with the rates that are used for projects to be carried out by state enterprises such as a LLDC . The rates are 2.50% for land, 5.00% for the costs of the LLDC until refinanced through the Infrastructure loan at 3.50%.

[13] See Savills report on Residential Development Margin – Competitive Return to a Willing Developer – March 2017

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The absence of a clearly defined corporate structure is a major impediment to assessing viability. NEGC Ltd was formed in late 2016 and has raised £7.6m of public funds and is now asking for a further £16-20million in start-up funding. By now it should have published a corporate structure and funding strategy.

We note for completeness the recent Colchester Council decision not to provide further funding to NEGC Ltd which casts further confusion onto delivery structure considerations.

5. Contingency and Optimism Bias

AY have included 10% contingency, which we continue to regard as far too low (see our 2018 and 2019 consultation responses) at this stage of project definition. There are not even sensitivities at 40% as recommended by the Inspector, which is clearly indefensible in context – again we assume that including appropriate contingencies does not fit well with the accompanying viability narrative.

AY state twice (in paras 19 and 44), that Grant Thornton have made an allowance for optimism bias, a step that could reduce the contingency needed if it had been done.

19. NEGC has been advised on the cost of infrastructure by Gleeds, and in respect of the Rapid Transport Link by Jacobs. A copy of the main costs and timings we have adopted is attached. In summary, the figures excluding optimism bias, are below; Grant Thornton has made allowance for optimism bias in the modelling :

44. The infrastructure works have been costed by Gleeds. The testing by Grant Thornton includes an allowance for Optimism Bias as appropriate. The phasing of the works for 300 units per annum is consistent with that adopted by Hyas, and for 500 units per annum has been accelerated consistent with the faster delivery.

However, Paras 19 and 44 appear to be materially misleading because there is no optimism bias allowance in the figures from which conclusions are being drawn. The Gleeds assumptions attached to the AY report specifically state that Optimism Bias is excluded from the figures, and is being reported on separately by Grant Thornton to NEGC. The figures provided in the report are close to the Gleed figures - there is no room for any material optimism bias to have been included.

EXD049 also states that the upper estimates in EB/079 include 44% for optimism bias. This may be true, but a careful look at page 39 of the Avison Young report confirms that the lower figure is taken through to the appraisal.

This shows again that the Avison Young words are not supported by the figures and cannot be relied upon.

Our summer 2019 Further Evidence consultation response[14] explains why a contingency of at least 40% is needed on all infrastructure expenditure *at this stage of project definition*. It should be much higher than the 5-10% allowed in s106 negotiations when much more detail is known.

If a lower figure is used for some items then we need a much a higher figure for major transport infrastructure to reflect the track record of such projects elsewhere and international best practice. But as mentioned above, the Avison Young report does not even include the base contingencies suggested by the Inspector, let alone consider in responsible fashion other risk sensitivities to the projects.

6. Serviced land prices

The table below highlights some anomalies in the price at which serviced land is sold to plot developers in Avison Young (para 30) and Hyas (EB086 appendix). Plot developers are assumed to pay similar prices for market housing land (£4.9m per hectare in both) and intermediate housing (£2.5m and £2.88m), but very different amounts for some of the other tenures. In particular affordable housing is increased from £.21m to £1m per hectare, and the residuals for flats are much lower, something that surprises us given the higher densities achievable with flats. We would need to see the full model to understand exactly what is happening: it could be AY's inclusion of 20% flats, or it could be an error buried too deep for us to see.

Avison serviced land prices compared to Hyas

	Avison £m per acre	£m per hectare	Hyas per hectare
Maket housing	2.0	4.9	4.94
Market flats	1.0	2.5	
Affordable rent housing	0.4	1.0	0.21
Afforrdable rent flats	-0.3	-0.7	
Intermediate houses	1.0	2.5	2.88
Intermediate flats	1.0	2.5	0.00
PRS houses	0.7	1.7	0.00
PRS flats	0.3	0.7	
Elderly houses	0.1	0.2	
Elderly flats	0.2	0.5	0.00
B1	0.0	0.0	0.00
B2 - B8	0.4	1.0	0.43
Retail & Leisure	0.6	1.5	3.97
Food - convenience	1.0	2.5	

[14] http://www.cause4livingessex.com/about-cause/cause-papers-and-evidence/

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7. Land Purchases

Timing: AY have gone some way towards the up-front land purchases which we believe to be necessary. Their cash flows show the land purchased over 18 years from 2025 to 2042[15]. This It is still a long period which reduces the Net Present Value to 52% of the undiscounted value[16] but it is better than 80 years which reduces NPV to 15% of the undiscounted value. <u>The impact of timing is fundamental and future values must not be compared to current land prices</u>.

	WOB	CBB	TCB
Land £milllion per Avison Young	40	41	76
Hectares (assuming unchanged from Hyas)	685	424	1170
£ per acre per Avison	23641	39149	26298
Land purchases start	2023	2025	2023
Land purchases finish	2028	2042	2028
Years spread over	6	18	6

Interestingly WOB and TCB land is paid for over 6 years from 2023 to 2028, a payment schedule that may be achievable, but still reduces 2020 NPV to 69% of the undiscounted value. <u>It is the discounted values that should be compared to current land prices</u>.

CPO: AY are relying on advice from their specialist CPO team (page 1), but they are not prepared to disclose that advice due to the sensitivity of land negotiations. This is a fundamental flaw that goes to the root of the plan. We need to see the whole report, asking ourselves the following questions:

1. How will they comply with paras 142 and 143 of the MHCLG CPO Guidance? The SoS must have regard to public interest and any proposals which the existing landowners may be putting forward.

2. Will the later tranches of land be able to be CPO'd at the same price as the earlier tranches, given that the scheme will be part built? Compensation is calculated on the assumption that the "scheme" is cancelled on the later valuation date by which time the hope value would be sky high. <u>Our Counsel's opinion shows how difficult it will be to CPO land at low values on a deferred basis</u>. A range of issues ranging from valuation

[15] The Avison Young addition to the NEGC Hearing Statement on Matter 5 claims describes it as spread over 12 years which is not the case. Another example of differences between the numbers and words which we interpret as a mistake.

[16] The 2020 Net Present Value of payments made from 2025 to 2042 at 6% is 45% of the undiscounted value – ie reduction of more than half.

to blight and funding while compensation is determined need to be specifically addressed;

3. How will they raise money for CPO before the amount of compensation is known? The uncertainty while awaiting a Lands Tribunal determination will be off-putting for any MEOP lender.

4. Is there careful testing around key assumptions underlying the CPO analysis (e.g. potential for alternative development where using the Dentons advice as an example, the whole report is premised on input from the Council which of course is not appropriately objective given their potential commercial involvement)?

CBRE evidence: the £23k/£39k/£26k per acre allowed for CPO costs is far below the £100,000 per acre benchmark cost approved for Welborne Garden Village by Fareham Borough Council advised by CBRE based on comparable strategic sites nationally.

CBRE has credibility on this subject: to quote from their Welborne report page 24 *"CBRE …. has significant experience of advising strategic sites. For example, we have advised Homes England on investments from its HIF fund on circa 15 Large strategic sites over the last 12 months. In addition, we advise a number of master developers and investors on bringing forward strategic sites and are also retained to dispose of serviced plots to house builders. Examples of this include advising Land Securities on Easton Park (10000 homes), Crest Nicholson at RAF Wyton (4750 homes) and Grainger at Wellesley (3850 homes)."*

They go on to say *"In our experience £100k per acre is the minimum price that strategic land is acquired for. We have recent experience of other strategic sites where the option agreements have values of up to £300k per acre."*

CBRE are advising under the recent MHCLG viability guidelines, which are slightly different from CPO compensation rules. But in commercial practice the figures should be very similar. CPO compensation is calculated as EUV + no scheme hope value whereas the viability guidance calculates EUV + a premium to incentivise landowners to bring forward land for development. Both calculations should lead to the market value of the land, ignoring any increment due to the specific scheme.

This CBRE evidence supports our view that the benchmark land value for the sites should be £100,000 per acre + acquisition costs, rather than £10,000+ implied by Hyas, or the £23/39/29k used by Avison Young.

8. Delivery Rates

Like Hyas, Avison Young have ignored the Inspector's advice that *"it would be more prudent to plan, and carry out viability appraisal, on the basis of an annual average of 250dpa."* This

is already higher than the 170pa average for large sites calculated by NLP[17], and already takes into account the market strength of the area, the size of the site(s) and public sector involvement in infrastructure provision. It also ignores the realities of the market, as analysed in a study for Glasgow University and then Communities & Local Government[18]. This found that, *"When too many developers are operating in one area, then their collective supply begins to approach the finite rate of absorption."*

Instead the lowest rate considered by AV is 300dpa, with no consideration of 170dpa or 250dpa even as sensitivities.

Indeed, AY even note in para 15 that, *"It is acknowledged that the economic cycle will affect the rate of delivery and absorption"*, which makes the refusal even to test the Inspector's suggested delivery rate to be all the more peculiar. Again, we suspect that the resulting viability conclusions do not fit well with the desired narrative.

AY's inclusion of 500dpa is even more optimistic. It promises a 'dash for growth' with more social, PRS and retirement housing and only 40% market housing. If successful, the speed of delivery is shown to improve viability by more than the cost of the "Letwin diversity". Although an interesting theory, it remains unproven in practice and is an unsound basis for a Plan.

However, one key aspect of delivery rates not considered by AY at all is the impact of potential CPO delays on the delivery of the project. Such delays (see above) are a virtual certainty and would be hugely viability-negative, yet the early delivery rate is not even sensitised down to the sort of level the Inspector recommended. This is patently too aggressive an approach to the analysis.

9. Inflation Assumptions

The Inspector specifically noted that including inflation in the viability analysis was not desirable. We agree, and note that here – as in the new Hyas report – inflation appears to have been utilised, against the Inspector's instructions, because it appears to create a better viability narrative. We will consider the inflation scenarios below for completeness, despite the obvious problems with attempting to justify the soundness of a Local Plan on inflation-based modelling.

AY in para 37 have "applied inflation at 0.5% and 1% to serviced land values, which is a conservative assumption to illustrate the potential outcome". We disagree: at 1% over 80 years, values would increase by 220%[19] while infrastructure costs remained constant – not a conservative assumption.

[17] Start to Finish – How quickly do Large-scale Housing Sites Deliver? (Nov 2016)
[18] https://www.gla.ac.uk/media/Media_302200_smxx.pdf
[19] 1% compounded for 80 years gives 220% increase. 1.01^80=2.2.

> 37. As can be seen, the average annual increase in house prices has exceeded build cost by a significant margin except over the last few years. We have applied inflation at 0.5% and 1% to serviced land values, which is a conservative assumption to illustrate the potential outcome.

We note that AY have inflated their income while leaving their costs constant. Presumably they justify this by arguing that it is only the differential inflation that matters because inflation should be taken out in the discount rate. This is a valid but risky shortcut. Proper inflation modelling would be done with all items inflated and discounted back with a higher cost of capital. It would be useful for analysis of peak debt requirements.

Like Hyas AY have extrapolated recent trends forward over 80 years. Our consultation response argues that this approach is dangerously misleading, especially when the results are relied upon for investment decisions. An internally consistent analysis which reflects government policy and market expectations is needed.

It is particularly unfortunate that AY openly connect inflation assumptions with extra expenditure (See paras 47 and 48). Inflation does not create real value, and it is simply unsound to promise benefits on the basis of an unknown future variable.

> 47. If inflation is included then the results show that there is a significant opportunity to provide for (1) a greater range or level of social and community infrastructure and/or (2) a wider range of housing products and/or (3) a greater level of affordable housing products.

10. Missing Information

Guidelines on disclosure

Extract from Viability Guidance PPG updated May 2019

"It is the responsibility of site promoters to engage in plan making, take into account any costs including their own profit expectations and risks, and ensure that proposals for development are policy compliant".

Harman guidance page 21

Any appointed consultants providing technical support must therefore be able and willing to engage fully with that wider group on behalf of the client authority.

The approach will also be greatly assisted by avoiding 'black box' models where partners are unable to see (and therefore review or challenge) the basis on which the approach produces its outputs.

We are still missing the key evidence on Compulsory Purchase prepared by Avison Young's specialists (we furthermore note a lengthy list of very valid questions from Galliard in the

same context, in their hearing statement). Without it we cannot know how NEGC will answer the key questions in our Land Acquisition Strategy paper[20] and legal opinion[21]:

- Will they fix the price of land purchased now, or later?
- How will they apply CPO on a deferred basis given that CPOs must be complete within three years?
- How will they raise funding for land purchases under CPO if landowners challenge the compensation given that the Lands Tribunal may take up to ten years to decide?
- How will they demonstrate that the CPOs are in the public interest when the landowners want to do much the same thing?

Each of these key questions needs a proper answer before there can be evidence of deliverability.

11. Conclusion

NEGC's appraisal evidence has little to add to the Hyas work.

We had high expectations from the substantial budget available[22] and the involvement of significant names such as Grant Thornton and Avison Young. We were told that the Hyas viability work was necessarily narrow in scope because it was prepared to meet planning guidelines.

But even on AY's aggressive assumptions the GCs are, at best, marginally viable. With realistic assumptions on land purchases, delivery rates and contingencies, the IRRs would turn negative.

Our overall conclusion remains the same – the GCs are too big to be economically efficient and cannot deliver their infrastructure promises. Massive public subsidy would be required. If the viability work had been done properly, any new settlements would be much smaller and make better use of existing infrastructure.

William Sunnucks
Matthew O'Connell
9 December 2019

[20] http://www.cause4livingessex.com/wp-content/uploads/2017/07/4Summer2019Land-Acquisition-Strategy-paper.pdf
[21] http://www.cause4livingessex.com/wp-content/uploads/2017/07/18MartinEdwardsCAUSE-Opinion-28-Sept-2019FINAL.pdf
[22] By 31/3/2020 NEGC will have spent £7.6m.