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Affordable Housing Viability Study: Payments in Lieu Working Paper

London Borough of Camden

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Contents

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Introduction

This working paper forms an extension to the London Borough of Camden Affordable Housing Viability Study and considers a mechanism by which payments in lieu could be determined in the Borough.

London Borough of Camden's Affordable Housing Policy

Current Affordable Housing Policy in Camden requires all schemes with a capacity for 10 or more additional dwellings to make a contribution to the supply of affordable housing (1,000 sq m of gross built floorspace is considered to have capacity for 10 units, with each additional 100 sq m adding an additional unit). The overall affordable housing target is 50% of the total addition to housing floorspace, which applies to all schemes throughout the Borough with a capacity for 50 dwellings (or gross floorspace of 5,000 sq m) or more. For schemes between 1,000 sq m of gross built floorspace and of 5,000 sq m, the affordable housing required is determined by a sliding scale, starting with a requirement for provision of 10% of gross floor area in the form of affordable housing for schemes of 10 dwellings (or gross floorspace of 1,000 sq m) and rising to the full 50% requirement for schemes with capacity for 50 dwellings (or gross floorspace of 5,000 sq m) or more.

Approach

The approach to examining payments in lieu is based on the concept of 'value neutrality'. Through this any payment in lieu is set at a level that ensures the residual land value of a typical scheme subject to the payment in lieu is the same as if the target level of affordable housing were provided on site. This approach is consistent with the approach to determining viability in the main viability report, is intellectually robust and represents an easily understood basis for determining payments in lieu.

The approach therefore seeks to extract the financial benefit the developer would get from providing 100% market housing on site, as opposed to the relevant percentage of affordable housing. Consequently, this negates the need to calculate any uplift in the amount of affordable housing to be provided offsite to account for the increased level of private housing delivered onsite (as would be needed in other methods of calculating payments in lieu).

To ensure a consistent approach to that used in the Affordable Housing Viability Study, the archetypes (i.e. mix of typical schemes) used in the following analysis are based on those used in that report. However, the London Borough of Camden is only likely to consider payments in lieu on an exceptional basis. This will generally be more common for smaller schemes, where there is greater likelihood that there will be justifiable reasons why affordable housing cannot be provided on site.

In view of the application of Payments in Lieu to smaller schemes, DTZ has assumed that the analysis should focus on those archetypes that deliver less than 50 units. The 'small site' archetypes used are therefore G, H, I, & J. Archetype K has been excluded from consideration since it falls outside of policy. Archetype L has been modified to consist of 5 five bedroom flats. Including this archetype ensures a realistic scenario is analysed where the number of private units falls under the affordable policy threshold but where the development floorspace exceeds this.

The characteristics of each of the archetypes used are set out below in Figure 1.

Figure 1: Archetype Characteristics

Archetype	Unit Number	Floorspace (GEA) at 0% affordable	Policy Affordable %
G	45	3,738 sq m	45% (on units)
H	34	3,046 sq m	34% (on units)
I	25	2,488 sq m	25% (on units)
J	15	1,411 sq m	15% (on units)
L	5	1,046 sq m	10% (on floorspace)

The viability model has been run for a 'policy on' scenario based on the above affordable percentages and a 0% affordable / 100% private scenario. The difference in residual land value between these two scenarios for each archetype reflects the value gain to the developer in not providing any affordable housing on site. These value differences have been converted to £ per sq m figures, based on the affordable floorspace in the 'policy on' position. All floorspace figures are expressed as gross external area (GEA).

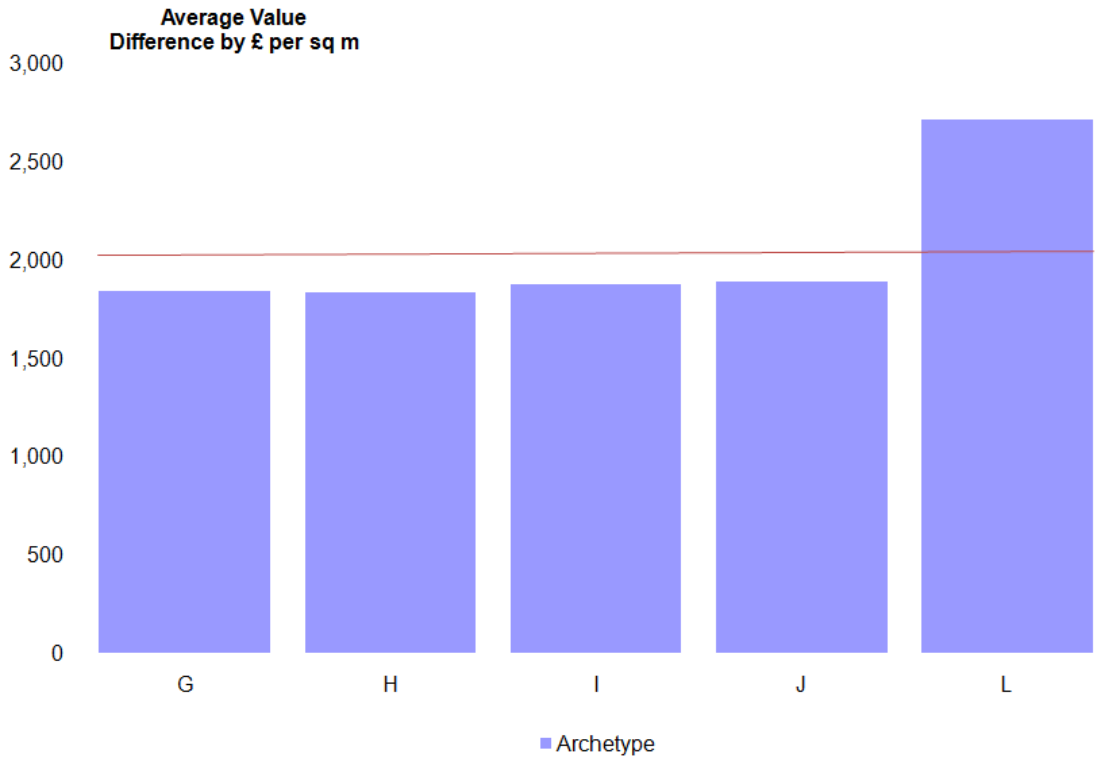
Value Difference by Archetype

Value differences have been produced across the above archetypes (taking an average across all value areas in the borough). Figure 2 below sets out the average value difference for each of the archetypes. This indicates a range of £1,840 to £2,719 per sq m (GEA) of the on-site affordable housing target, with an average figure across these archetypes of £2,035 per sq m. This is also shown in graphical form in Figure 3 (with the solid red line indicating the average value across the archetypes).

Figure 2: Average Value Difference by Archetype

Archetype	Total Dwellings	Floorspace (GEA) at 0% affordable	On-site Affordable Housing Target	Average Value Difference per sq m
G	45	3,738 sq m	1,682 sq m	£ 1,848
H	34	3,046 sq m	1,036 sq m	£ 1,840
I	25	2,488 sq m	622 sq m	£ 1,877
J	15	1,411 sq m	212 sq m	£ 1,891
L	5	1,046 sq m	105 sq m	£ 2,719
Average	-	-	-	*£ 2,035*

Figure 3: Graph showing Average Value Difference of Archetypes



Source: DTZ, 2010

Value Difference by Area

The above analysis considers value differences for each archetype. The following analysis takes the overall average difference for these and examines how this changes across each value area.

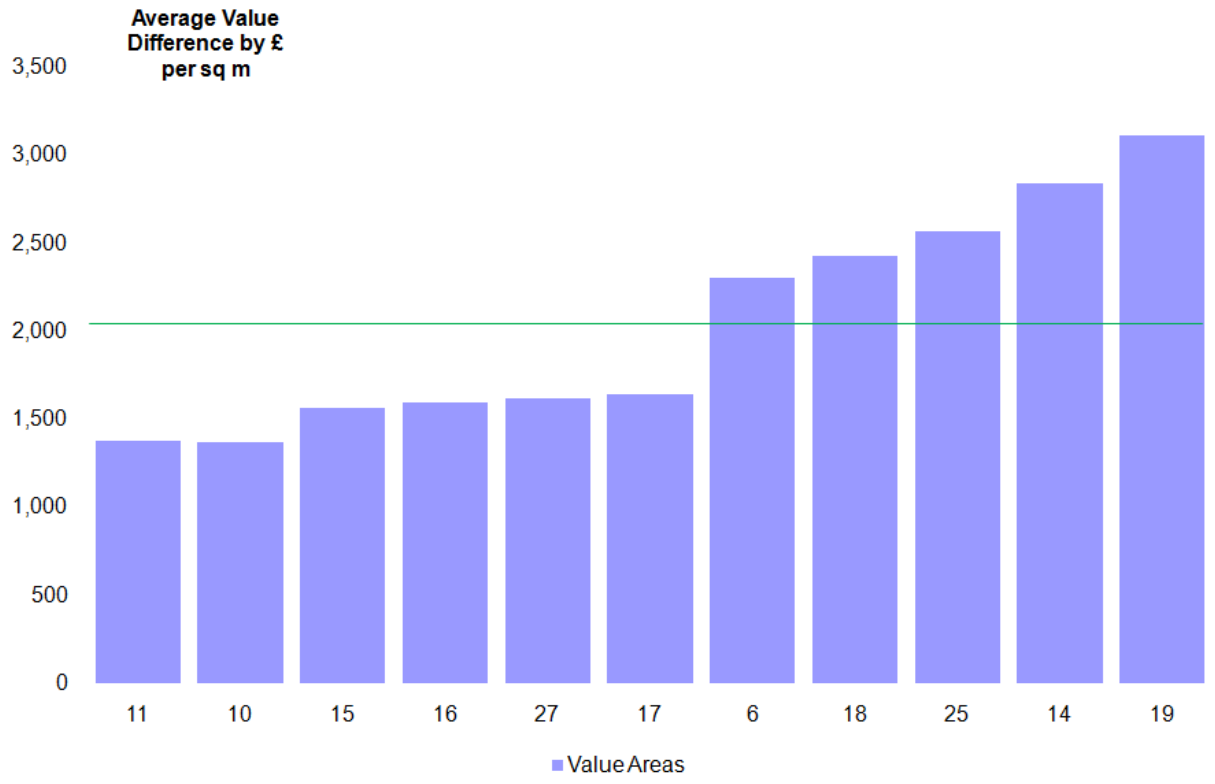
As Figures 4 and 5 below show, there is considerable variation across the value areas, with two broad bands of areas across Camden with similar value differences (below £2,000 per sq m GEA and above £2,000 per sq m). These two bands are indicated by the solid green line on Figure 5. Overall, the five value areas in the upper band have an average value difference of £2,647, which is 30% higher than the overall average for all value areas of £2,035. The average for the six areas in the lower band is £1,526 (25% below the overall average). For consistency, the Value Areas in the figures below are numbered as in the main viability report and ordered by value difference.

It should be noted that the value areas are best fit aggregates of smaller areas with similar sales values, and there is likely to be considerable variation within each value area. While this aggregation is in line with the main viability report and allows the model to analyse the broad differing values across the borough, it does not provide a firm basis for policy differentiation on an individual value area basis.

Figure 4: Average Value Difference by Value Area

Archetype	Unit Number	Policy Affordable %
11	Euston & Somerstown	£ 1,377
10	Kings Cross	£ 1,369
15	Kentish Town	£ 1,562
16	Camden Town	£ 1,590
27	Clerkenwell & Hatton Garden	£ 1,615
17	West Hampstead	£ 1,641
6	Bloomsbury & Holborn	£ 2,302
18	Belsize Park	£ 2,422
25	Frognal & Fitzjohn's	£ 2,561
14	Primrose Hill / Chalk Farm	£ 2,838
19	Hampstead Heath & Highgate	£ 3,112
Average	-	*£ 2,035*

Figure 5: Graph of Average Value Difference by Value Area



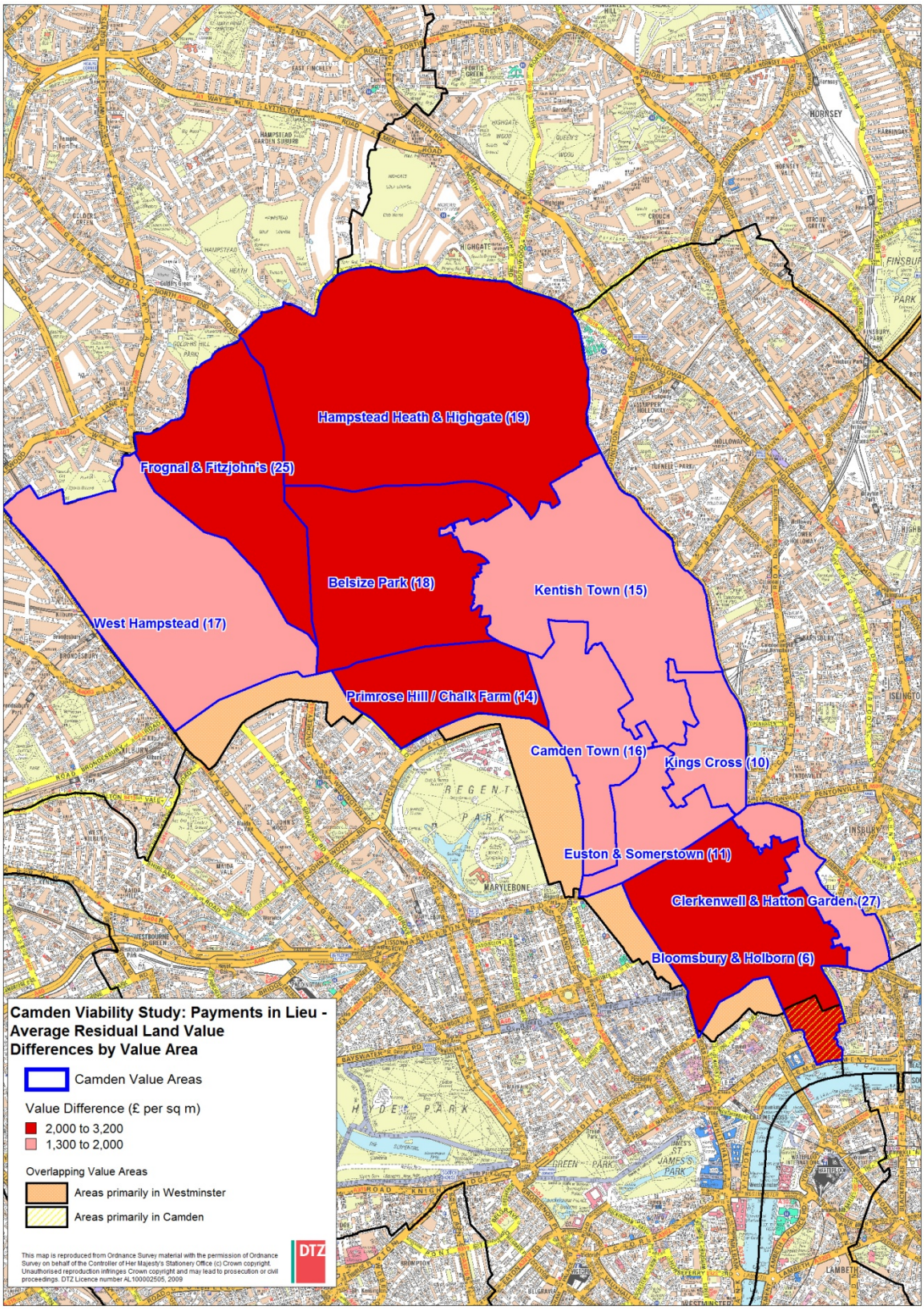
Source: DTZ, 2010

The geographical spread of these value differences is shown in the map below (Figure 6). The pattern of value areas in each band broadly corresponds with those seen in the maps displaying sales prices by LSOAs in the main viability report and indicates that, in terms of average value difference by area, there is a high extent of geographical clustering across the borough of areas with similar values.

There are some small areas of the borough not covered by the above value areas, as they cross the borough boundary between Camden and Westminster. These are covered by value areas that lay predominantly in Westminster (namely St John's Wood, Regents Park, Fitzrovia and Covent Garden) and have therefore not been included in the main analysis.

Data from the Westminster Viability Study indicates that average sales values within these areas are generally high. St John's Wood and Regents Park have slightly higher values than nearby Primrose Hill / Chalk Farm (by around 9-18%), and Fitzrovia and Covent Garden have broadly similar sales values (i.e. within 3% of each other) to neighbouring Bloomsbury & Holborn. The viability of schemes within these areas is therefore likely to be in line with the figures for the higher value areas discussed above.

Figure 6: Map of Average Value Difference by Value Area



Recommendations

Use of Payment in Lieu

The 'value neutrality' approach provides a robust and justifiable basis for determining a payment in lieu figure. In various circumstances though, developers may prefer to make a payment in lieu rather than provide affordable housing on site. This is on the basis that:

- either the developer believes that having some affordable housing on site reduces the value of the market (or intermediate for sale) units; that is, a 100% market value scheme will have a higher residual land value, even after a payment in lieu, compared with the scheme with on site provision.

- or if the provision of affordable housing on-site increases costs or reduces the net development floorspace; this could be the case where, for example, it is deemed necessary to provide separate access arrangements for the affordable units, or the size and design standards applying to affordable units make for less efficient use of overall space.

We therefore recommend that payments in lieu should be regarded as only applicable in exceptional circumstances (and typically only on small schemes), where neither on site provision nor off site provision is practical.

In theory, based on the above reasons, developers might be willing to pay more than implied by a payments in lieu figure determined through the 'value neutrality' approach. In practice this willingness to pay extra would be very dependent on the individual characteristics of the development, and attempting to extract these higher payments would probably be counterproductive in terms of time spent in negotiation and having to review the viability of often small schemes.

Payment in Lieu Figure

From the above analysis of the small site archetypes (i.e. G – J and L), the average value difference is £2,035 per sq m (GEA) of the on-site affordable housing target (averaged across all value areas). The further analysis by value area suggests that there are two distinct bands of value difference in Camden, with the areas in the upper band having an average value difference 30% above the average across the borough.

There is a theoretical case from this analysis of requiring a greater payment for developments in higher value areas. However, current on-site affordable housing policy in Camden is based on a single sliding scale and does not differentiate between value areas across the Borough. As such, establishing an approach to payments in lieu that differentiates between value areas would be inconsistent with the wider affordable housing policy.

Given this and the above analysis, there are three policy options that could be adopted as the basis for a payment in lieu figure:

- Set a payment in lieu at the level of the average figure for the lower band value areas. This would ensure that the majority of schemes likely to be subject to a payment in lieu would continue to be viable under the policy. However, while this option seeks to avoid deterring development, it may miss gaining as much payment from developments as would otherwise be possible. A recommended payment in lieu amount based on this approach is **£1,550 per sq m GEA** of the on-site affordable housing target.

- Have a payment in lieu figure based on the average figure for the higher band value areas, with a willingness to negotiate this down depending on the size, mix or viability of individual schemes. This is likely to result in a greater gross payment in lieu income, but would also require greater council time and resources to negotiate and administer these payments. A recommended payment in lieu figure based on this is **£2,650 per sq m GEA** of the on-site affordable housing target.

- Set a payment in lieu figure at the level of the average value difference across the borough. This would strike a balance between extracting as much value as possible from each scheme (i.e. keeping as many as possible at a 'value neutral' position), and not deterring development or requiring the council to negotiate over the majority of schemes. Although this approach would likely result in a minority of schemes needing flexibility, if payments in lieu are allowed only in exceptional circumstances then these should only require minimal resources to administer. A recommended payment in lieu figure based on this approach is **£2,050 per sq m GEA** of the on-site affordable housing target.

Floorspace Conversion

To calculate payment in lieu amounts, the GEA on-site affordable housing target needs to be multiplied by the preferred payment in lieu figure per sq m of GEA. Where only a Gross Internal Area (GIA) figure is known, this needs to be converted to GEA. In line with the main Affordable Housing Viability Report, the modelling has assumed that the gross internal build areas are 80% of the gross external area for flats and 95% of the gross external area for houses. Therefore, the following multipliers should be used to convert GIA floorspace to GEA:

- Flats: GEA = GIA x 1.25

- Houses: GEA = GIA x 1.053