Melton Borough Council
Commuted Sums for Affordable Housing

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Summary of the project

S1 This report aims to provide Melton Borough Council with advice on commuted sums for Affordable Housing. In some instances, Affordable Housing provided on site is not the optimal solution and then a payment-in-lieu is the best way ahead.

S2 This is a conventional and legal approach used typically where the site is not in a sustainable location (transport links being distant for example); where the site mathematics don't work out or where a housing association cannot be found to take on-site Affordable Housing.

S3 The report stands alongside other policy development which supports Affordable Housing targets and thresholds. The work is intended to be used to support Supplementary Planning Guidance which the Council are developing.

S4 The report covers a whole range of commuted sum related issues including a review of current practice from across England and a survey from other Leicestershire local authorities. It provides indicative commuted sums for the different Value Areas of the Borough, and these are further broken down on a per unit and a per square basis. The work was commissioned by Celia Bown, Housing Policy Officer at the Council.

S5 The approach recommended seeks to place land owners in the same financial position whether there is an on-site contribution or by way of a payment-in-lieu. The amounts recommended should allow a housing association of other provider of Affordable Housing units to 'gap fund' Affordable units taking into account the value of the unit (typically through housing association rents) and the value of land likely to have to be paid.

S6 The methodology is a 'residual development' approach which takes into account costs, values and the level of margin needed for a developer.

S7 It should be noted that commuted sums are still subject to a viability test and the Council accepts that this will be necessary in some instances.

1 Project brief and background

1.1 Melton Borough Council is developing currently, supporting documentation to assist with the delivery of the emerging new Local Plan (2011 – 2036).

1.2 Key to the implementation of the Plan is the delivery of Affordable Housing and an Affordable Housing and Housing Mix Supplementary Planning Document (SPD) is under development.

1.3 An important aspect of the SPD relates to commuted sums which provide an alternative approach to on-site Affordable Housing development where it is decided that a payment-in-lieu is a fair and efficient means of contribution.

1.4 The Council wish to have supporting information for the SPD which can help to deliver Affordable Housing through off site contributions.

1.5 This work considers a range of options for setting commuted sums including site-by-site, as well as formulaic approaches, and makes a recommendation for an optimal approach, where the Council and other agencies agree than a payment-in-lieu is an appropriate solution to a particular site.

1.6 The work draws on a survey within Leicestershire as well as a wider survey exercise, looking at how local authorities across England generally deal with commuted sums.

1.7 This project sits alongside current viability work being developed by Cushman and Wakefield, who have updated analysis on behalf of the Council.

1 Policy and market issues

2.1 The relationship between residual value and land value benchmark is key in developing deliverable policy.

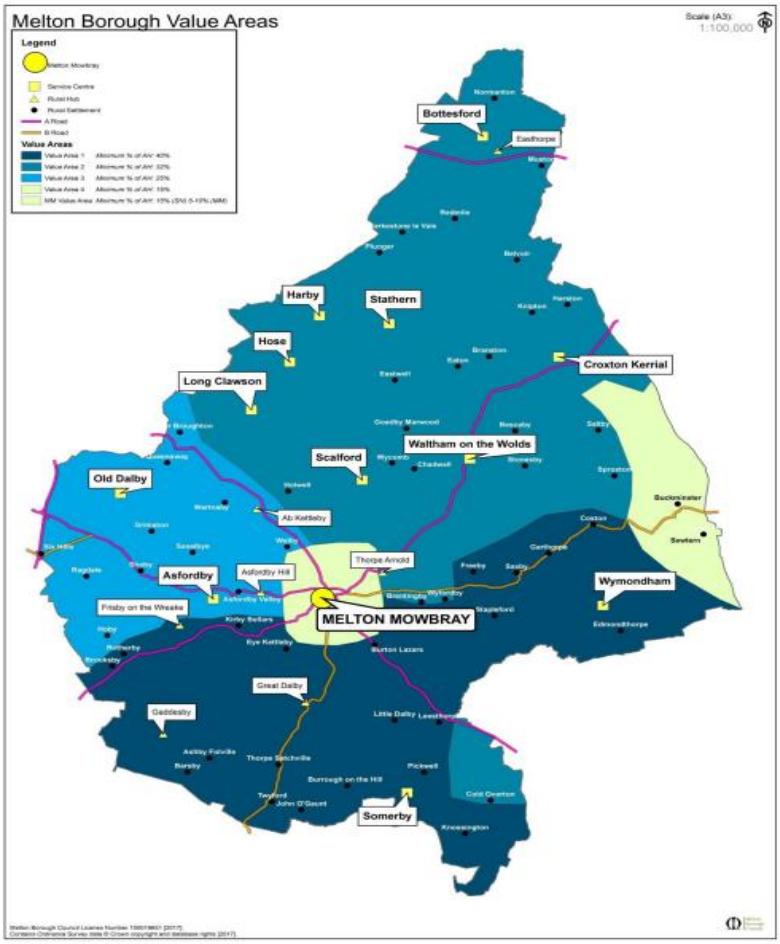
2.2 Previous analysis (Cushman and Wakefield, May 2017; Revised Local Plan and CIL Levy Viability Study) shows a range of residual values reflecting, principally, house price differences between sub markets.

2.3 That research assisted the local authority in their negotiations on a site by site basis in recent years.

2.4 The emerging Local Plan is supported by updated viability assessment work. A whole plan viability assessment has been undertaken (Revised Local Plan and Community Infrastructure Levy Viability Study, Cushman & Wakefield, May 2017).

2.5 That work establishes five value areas across the Borough of Melton based on viability considerations. The map (Map 1) of the areas is shown below:

Map 1 Melton Borough Value Areas



Source: Figure 6: the Adopted Melton Local Plan, 2011-2036

2.6 The analysis results in Affordable Housing targets as set out in the table (Table 2.1) below:

Table 2.1 Affordable Housing targets in the Melton BC area

Location	Minimum percentage of affordable housing
Value Area 1	40%
Value Area 2	32%
Value Area 3	25%
Value Area 4	15%
Melton Mowbray Northern SUE	15%
Melton Mowbray Southern SUE	15%
Melton Mowbray	5% -10%

2.7 There is now further work being carried out which will update his policy position.

Commuted sums

2.8 Previous experience suggests that there are two broad generic ways in which commuted sums are calculated:

2.9 Site by site: reflecting the very particular circumstances of schemes, and by reference to existing use value or some other relevant benchmark value.

2.10 By formula: this approach sets out a calculation which is intended to give an indication of what should be paid by the applicant.

2.11 Under both circumstances, the sum sought should be subject to a test of viability. This is in line with the NPPF and forerunning guidance on viability.

2.12 If it is agreed between an applicant and the local authority that a commuted sum is the appropriate way of making an Affordable Housing contribution and there is no formula for calculating that commuted sum, then the most appropriate way is likely to be by way of a site specific assessment and potentially, negotiation.

2.13 However, it should be borne in mind that the differential will be subject to an overall viability test, and in particular the financial relationship between the residual value and the land value benchmark.

The Revised NPPF (July 2018)

2.14 Initially, at the national level, the National Planning Policy Framework stated (Paragraphs 173 and 174) that:

> 'Pursuing sustainable development requires careful attention to viability and costs in plan-making and decision-taking. Plans should be deliverable. Therefore, 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.
>
> Local planning authorities should set out their policy on local standards in the Local Plan, including requirements for affordable housing. They should assess the likely cumulative impacts on development in their area of all existing and proposed local standards, supplementary planning documents and policies that support the development plan, when added to nationally required standards. In order to be appropriate, the cumulative impact of these standards and policies should not put implementation of the plan at serious risk, and should facilitate development throughout the economic cycle. Evidence supporting the assessment should be proportionate, using only appropriate available evidence'.

2.15 However, the Revised NPPF (July 2018) appears to do away with a formal definition of viability; i.e. the previous paras (173 and 174) which dealt with the willing developer and land owner and competitive returns have been removed.

2.16 The most relevant paragraph of the Framework now appears to be Number 57 which deals with the circumstances under which viability assessments may be submitted with the application. These would seem to be:

- The Plan is out of date;
- Whether there have been changes in the site viability since the time of Plan;
- Whether there are 'particular' circumstances which would seem to warrant a site specific assessment.

2.17 Otherwise Para 57 states that where plans are up-to-date, applications should be assumed to 'be viable'.

3 Key viability factors affecting development

Generally

3.1 The delivery of Section 106 contributions, of which Affordable Housing is highly dependent, relies on a clear definition of what is, and what is not, viable. This principle applies importantly, whether the Affordable Housing contribution is in the form of units on site, or in the form of a commuted sum which may be spent at an alternative site.

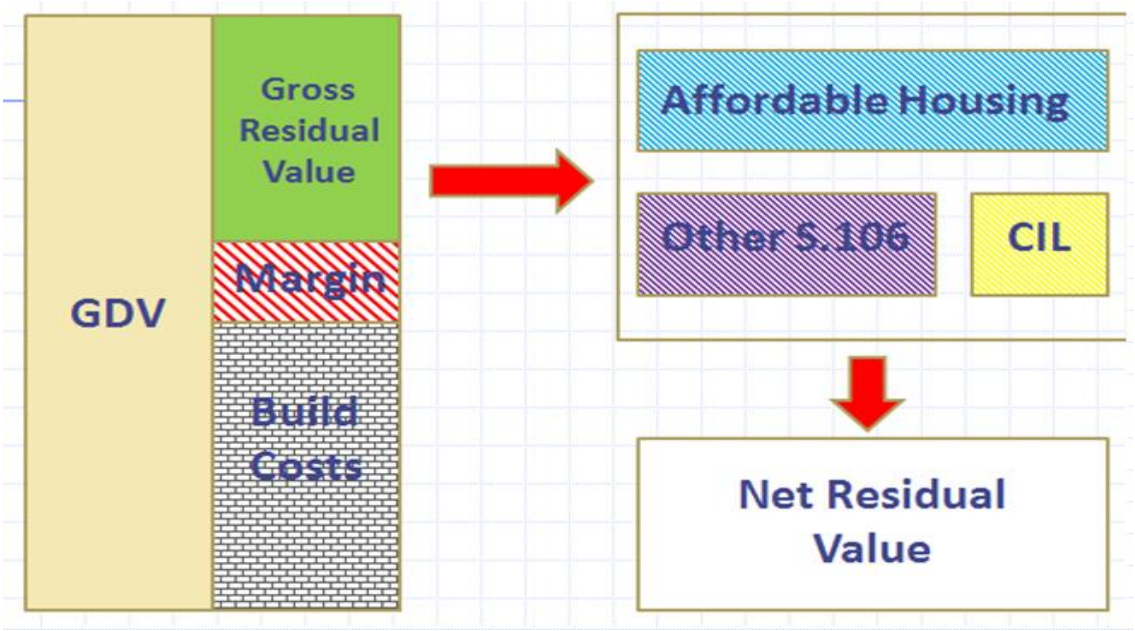
3.2 The Council will need to be aware of the factors to take into account, when both developing policies and negotiating specific schemes. There is a range of guidance including the Revised NPPG (National Planning Policy Guidance, 2018), the RICS's Planning and Viability and the Harman Report as well as a range of case law judgements on viability.

3.3 There is a considerable degree of unity in guidance and legal precedent on the assessment of viability through the planning process.

3.4 The assessment of viability is usually referred to a residual development appraisal approach. This is set out in the diagram below. This shows that the starting point for negotiations is the gross residual site value which is the difference between the scheme

revenue and scheme costs, including a reasonable allowance for developer return.

3.5 Once CIL or Section 106 contributions have been deducted from the gross residual value, a 'net' residual value results. The question is then whether this net residual value is sufficient in terms of development value relative to the site in its current use.

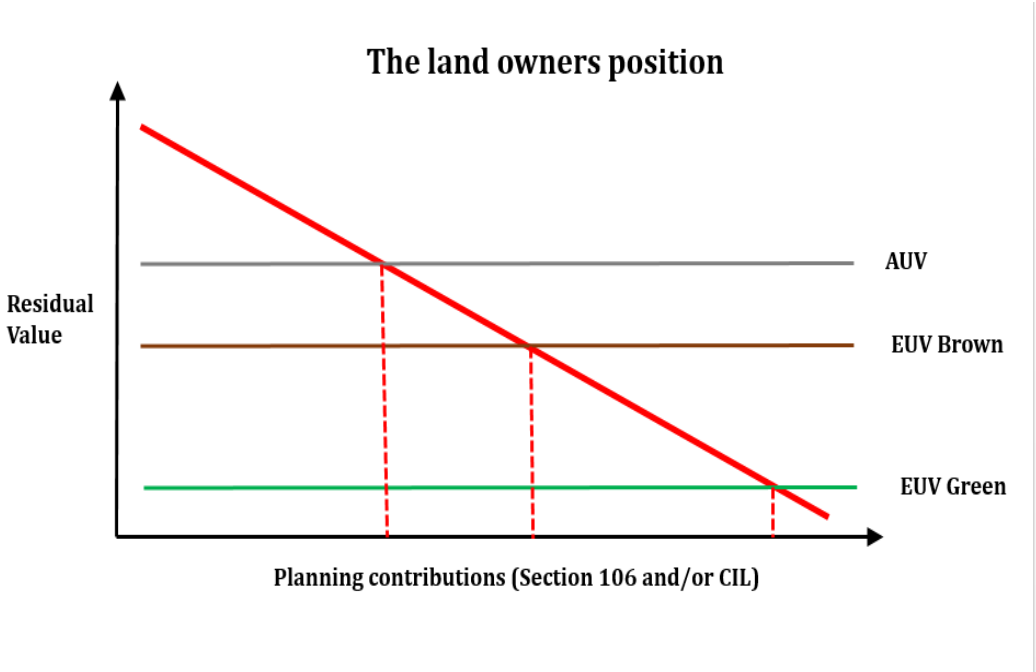


3.6 Calculating what is likely to be the value of a site given a specific planning permission, is however only one factor in deciding what is viable and what is not

Situation of the land owner

3.7 A site is unlikely to proceed where the costs of a proposed scheme exceed the revenue. But simply having a positive residual value will not guarantee that development happens. The existing use value of the site, or indeed a realistic alternative use value for a site (e.g. commercial) will also play a role in the mind of the land owner in bringing the site forward and thus is a factor in deciding whether a site is likely to be brought forward for housing.

3.8 The diagram shows how this operates. The land owner will always be concerned to ensure that residual value clears the relevant land value benchmark.



3.9 It is recommended that the Council in most instances adopts Existing Use Value (EUV) as the prevailing Land Value Benchmark (LVB) against which residual value (RV) is measured. This (EUV) is the recommended approach in the NPPF. The guidance states that:

'EUV is the value of the land in its existing use together with the right to implement any development for which there are policy compliant extant planning consents, including realistic deemed consents, but without regard to alternative uses.'

And importantly:

'Existing use value is not the price paid and should disregard hope value.'

And:

'Existing use values will vary depending on the type of site and development types. '

Land value and residual value

3.10 Indeed, it is important that the Council does not accept the price paid for land as the LVB. The land value is what is paid for the site and is a function of transactions in the market, some of which may prove

rational, and some of which may prove irrational; furthermore, some deals will reflect policy impacts and others, not.

3.11 Residual value is the driver for the assessment of viability and this determines what should be paid for sites, taking into account all the policy impacts.

Developer margins

3.12 It is important that the Council allows both land owner and developer to make a competitive margin in its negotiations on viability. This is consistent with the NPPF.

3.13 The margin required by developers will vary by scale of operation and by type of development. The NPPF suggests a range between 15% and 20% on gross development value. This should relate to the Market element of schemes.

3.14 It is well accepted that where private developers build Affordable Housing on behalf of RPs (Registered Providers) that a lower profit margin (typically 5-6% on construction cost) is appropriate. This is because there is a contract with a secure payment in place.

3.15 The return to the developer of Market Housing is a reflection of risk, and this is highly sensitive to market fluctuations. In a steadily rising market, a net margin (after fees and finance) of around 15% on GDV (Gross Development Value) is seen to be appropriate, although many appeal decisions are based on a 20% margin on GDV for Market Housing.

4 Review of other local authorities and how they deal with commuted sums

Leicestershire authorities

4.1 An e-mail survey was conducted to gauge the views of other authorities in Leicestershire. The survey is set out in Appendix 1 at the end of this report.

4.2 Four authorities responded – North West Leicestershire DC, Harborough DC, Hinckley and Bosworth BC and Blaby DC.

4.3 Generally the authorities adopt an Affordable Housing threshold at around 10-15 units following the Written Ministerial Statement of December 2014. Therefore they are not generally requiring commuted sums from smaller sites, despite the fact that some areas are relatively high value.

4.4 The exception is Hinckley and Bosworth which has a threshold of 4 units in rural settlements. Harborough, which is significantly higher value, does not have a low threshold such as this.

4.5 North West Leicestershire adopts a split target – at 11 units for green field, and 30 units for brown field.

4.6 Affordable Housing targets vary by location, with the exception of Blaby which seeks a flat 25% Affordable Housing across the district on sites of 15 units or more.

4.7 There are a variety of approaches taken to setting commuted sums. Hinckley and Bosworth utilise external consultants to calculate payments on a scheme by scheme basis. The general approach used is residual valuation and the amount payable is the maximum that the scheme can stand viably. Harborough use a negotiated scheme by scheme approach where again, external consultants look at what is viable. Affordable Housing is usually valued at around 50% of open market value. The approach in North West Leicestershire is similar, where the consultants appointed assess the commuted sum paid.

4.8 Blaby DC, in its Housing Mix and Affordable Housing SPD has a formula for assessing commuted sums. This is set out in the screenshot below:

Commuted Sum Contributions – Calculation Methodology		Example 1
Scheme of 20 dwellings		
Affordable Housing Contribution (25% of 20 = 5 units):		
Rent		3 units
Shared Ownership		2 units
OMV of each property =		£150,000
£150,000 x 5 =		£750,000
Amount RP will pay:		
Rented units =	(£ 80,000 x 3) =	£240,000
Shared ownership =	(£100,000) x 2) =	£200,000
Total =		£440,000
Commuted sum:		
OMV less Total RP value =		**£310,000**

The formula therefore takes the difference between open market value (here, £750,000), and the amount that a housing association will pay (here, £440,000): hence, the difference £310,000. This amounts to £62,000 per Affordable unit.

4.9 General feedback suggests that local practice could benefit from improvement. One respondent stated that the current 'process is quite complicated to assess and a simple more easy to understand process would be preferred. However we have yet to find an approach that doesn't have disadvantages and so we continue to believe this is as good as any other methodology'.

4.10 Another stated by way of general assessment: 'The Council have historically been successful in obtaining commuted sums from sites that qualified under the "exceptional" criteria and in using the funding to support RP delivery and latterly council own build within [the district]. The money received is predominantly from historic applications where a commuted sum was taken e.g. where there was no interest from RP's; where the S106 agreement sought a reassessment of viability if timescales were triggered; where

infrastructure contributions were prioritised over other contributions and the amount left was insufficient to provide full units; developments in unsustainable settlements with limited need etc.'

4.11 Most authorities stated a preferred on-site Affordable Housing contribution, rather than a commuted sum.

Other authorities from England

4.12 There are a range of approaches adopted by local authorities to commuted sums. A review of those available on the web has been undertaken (September 2018).

4.13 Classification of the different approaches is challenging, although the review generates some key questions which will face any local authority setting up guidance on commuted sums. These are as follows:

Generic or site by site?

4.14 Some local authorities choose to assess the quantum of commuted sums on a site-by-site basis; others choose to have a more generic approach, sometimes based on indicative figures based for examples on sub markets or local areas.

Commuted sum by formula or by model?

4.15 Some local authorities set out a specific formula which can be completed; some have a spreadsheet to be completed.

Level of complexity?

4.16 Choosing the level of complexity in determining a commuted sum is important. To a significant extent, this is determined by the Affordable Housing threshold – and whether officers will be dealing

with a low threshold, and hence a potentially high number of negotiations, or a high threshold, in which case the Affordable Housing issues are likely to be less voluminous.

Basis of the commuted sum calculation?

4.17 This is key, and is again linked into the level of complexity sough to some extent. The basis of the commuted sum calculation is dealt with here in a specific section.

Basis of the calculation: what approach and variables should drive the commuted sum?

4.18 The review of different approaches to commuted sums is set out in the table on the following page. Although close analysis suggests that there are very wide of approaches, it is possible to synthesise them into some general approaches. Such a general analysis could be along the following lines:

- Value driven approaches;
- Gap funding approaches;
- Residual value approaches.

4.19 These are now considered in more detail (Table 4.1)

Table 4.1 Commuted Sums: A Comparative Analysis

Local Authority	Source & Date	General Basis	Main formula	Key assumptions	Advantages	Disadvantages
Brighton and Hove CC	Guidance on Commuted Sums - May 2017 - DVS	Market Value	Market Value less Affordable Value	Based on sub markets	Relatively straighforward	Cost impacts not considered
				LHA for Affordable Rent	Updating straightforwrad	
				% OMV for Shared Ownership		
Charnwood BC	Affordable Housing Delivery Advice - Oct 2016 - AGA	Residual Value	RV (100% Market) less RV (AH Target)	Based on High Level Testing	Applies equivalence principle	Need for HLT updating
				Residual Value drives CSs	In line with related policy analysis	
Eastbourne BC	Affordable Housing SPD - Nov 2018	Market Value	Market Value as indicator of Land Value	Fixed % Land Value		Estimate of LV constant
				Gives CS per Sq M		Cost impacts implicit
						Requires updating
Epsom & Ewell	Commuted Sum Calculator	Gap Funding	Market Value less Margin less AH Revenue	Gross Development Value	Some cost impacts accounted	Scheme specific
			Scheme specific by Spreadsheet	Profit Margin (at 20%)	Scheme specific	(But a high value area)
				AH capitalised revenue		
LB Ken & Chelsea	Kensington & Chelsea BC - Payments in lieu - BNPP - May 20	Residual Value	GDV - Dev Costs = RV v LVB	Software model	Applies equivalence principle	Requires bespoke data
LB Lambeth				Site by site	Scheme specific	(Especially LVB)
Luton BC	Commuted Sums - May 2016 - Three Dragons	Residual Value	RV (100% Market) less RV (AH Target)	Based on range of schemes	Applies equivalence principle	Requires bespoke data
				Residual Value drives CSs	In line with related policy analysis	
Newark & Sherwood	Council's SPD - July 2013	Equivalent provision	Value of on-ste AH	Variables not stated		Uncertain for participants
				Implicitly cost driven		No viability test specified
Northumberland CC	Affordable Housing Protocol - Nov 2016	Market Value	Fixed payments applied to scheme number	Scheme by scheme		Not clear that methodoly
		Equivalent provision		But applying the fixed table		meets equivalence principles
LB Richmond	Commuted Sums Guidance Note - Bespoke Property Group	Gap Funding	LB AH Calculator	Gross Development Value	Some cost impacts accounted	Scheme specific
				Profit Margin (at 20%)	Scheme specific	(But a high value area)
				AH capitalised revenue		
Rother	Financial Contributions for AH - EPD	Residual Value	RV (100% Market) less RV (AH Target)	Based on market areas	Applies equivalence principle	LVB accounted for?
				CIL accounted for		
Rushcliffe BC	Commuted Sum Guidance Note - July 2016	Profit Level	Residual but with profit as residual	GDV	Scheme specific	Land cost appears fixed
				Less land and build coists		Therefore CSs unlikely
Watford BC	Commuted Sums for Affordable Housing	Land Value	Market Value with % for land value	Gross Development Value	Based on postcode sectors	Not scheme specific
				Land Value		Land value based

Value driven approaches

4.20 Value driven approaches adopt mainly gross development of schemes as a way of determining the level of commuted sum payable. The table on the following page shows that from a reasonable sample of local authorities the GDV of a scheme features highly in determining the quantum of the commuted sum.

4.21 However, market value or GDV, is rarely used solely as a driver within a formula or spreadsheet. It is usually combined with another variable to work out the commuted sum payable.

4.22 For example, this is the approach adopted by Brighton and Hove (see table above) where the commuted sum is based on the difference between the market value of units and the value of Affordable units. This approach assumes that costs are neutral between both tenures and that profit margin doesn't feature as a critical factor. This approach is relatively straightforward, once the values are established for all tenures.

4.23 Alternatively market value still effectively drives the calculation of a commuted sum, but it does so in combination with land value, which is taken as a fixed percentage of market value and which then (land value) provides an indicative commuted sum. This approach is used by Eastbourne BC. The disadvantage of this approach is that % for land value appears not to vary by location but rather by dwelling type. The approach also may not produce equivalent (on and off) site outcomes.

4.24 A similar market driven formula is used by Northumberland where the value provides indicative commuted sums. From a reading of the Council's protocol, it is not clear how the sums relate back to market value or to meeting the need for equivalent provision elsewhere in the form of a commuted sum.

Gap funding approaches

4.25 These are a more complex approach to determining commuted sums. From the sample of local authorities, they appear to be used more extensively in the south of England and in Greater London.

4.26 This model takes into account market value, Affordable Housing revenue and developer profit. It seeks, by using relatively few of the main variables affecting viability, to generate a commuted sum on the basis of the financial difference between market value, less the developer margin, and, on the other hand, the value of the Affordable Housing element. This approach has been adopted in, for example, the London Borough of Richmond and in Epsom and Ewell. Both these local authorities have a Commuted Sum Calculator that is completed by applicants on a scheme by scheme basis.

4.27 It is worth noting that with this type of approach, it is important that the tenure of Affordable Housing is agreed, along with the assumptions driving the value of the Affordable Housing – as the commuted sum is highly sensitive to these figures.

Residual value approaches

4.28 These approaches are without question the 'purest' type of commuted sum calculation in that, if adopted comprehensively, they catch all the variables in the viability equation, and deliver a sum that will put the land owner in the same financial position whether there is an on, or, off site Affordable Housing contribution.

The mechanics of the calculation are set out in the approach below.

The commuted sum is calculated as follows:

Step 1 Calculate scheme Residual Value assuming no Affordable Housing;

Step 2 Calculate scheme Residual Value assuming an Affordable Housing contribution is made;

Step 3 Calculate the difference between the figures produced at Step 1 and Step 2.

Example:

RV with affordable housing	£2.0 million
RV with no affordable housing	£2.5 million
Commuted sum (difference between the two)	£500,000

4.29 This approach can be worked up into, for example, a commuted sum per unit, or commuted sum per square metre (as with the Community Infrastructure Levy).

4.30 This approach is adopted in a number of studies and policies; notably (please see the table above), Charnwood BC, Luton BC and Rother.

4.31 A derivative of this approach is used by LB Kensington and Chelsea and LB Lambeth which adopt a similar spreadsheet which can be adjusted on a scheme by scheme basis for prices, costs, margins, Affordable Housing revenue and land value benchmark.

Other approaches

4.32 From the web survey a number of other approaches were identified, some being derivatives of the main approaches. One approach (Rushcliffe BC) appears to use the profit margin as the driver of whether or not a commuted sum is viable, where land acquisition price is fixed. It is envisaged that such an approach would provide many challenges for the authority in delivering commuted sums.

5 Recommended approach for Melton BC on commuted sums

5.1 Having reviewed the different approaches adopted both within Leicestershire and nationally, the approach recommended for the Council is set out hereafter.

5.2 The approach recommended is based on placing the land owner (from whom the Affordable Housing contribution should emanate) in precisely the same financial position whether there is an on-site Affordable Housing contribution, or a payment-in-lieu.

5.3 The approach involves running residual appraisals for all market locations and at a range of Affordable Housing targets – 0% to 40% (at 10% intervals). This analysis is based on high level testing of a notional one hectare site at 30 dwellings per hectare (typical family type housing scheme).

Key input assumptions

5.4 The analysis is based on data developed in conjunction with Cushman and Wakefield, who are currently working on the Local Plan and in particular, Affordable Housing and CIL (Community Infrastructure Levy) policies.

Values

5.5 Indicative values are shown in the table (5.1) below:

Table 5.1 Indicative sales values across the Melton BC area

Sub Markets	Detached			Semis	Terraces		Flats	
	5 Bed	4 Bed	3 Bed	3 Bed	3 Bed	2 Bed	2 Bed	1 Bed
1	£382,000	£339,000	£268,000	£232,000	£220,000	£192,000	£181,000	£127,000
2	£336,000	£298,000	£236,000	£204,000	£194,000	£169,000	£159,000	£112,000
3	£298,000	£264,000	£209,000	£181,000	£172,000	£150,000	£141,000	£99,000
4; Melton Urban Area & SNs	£267,000	£237,000	£188,000	£162,000	£154,000	£135,000	£127,000	£89,000

Source: Cushman and Wakefield, 2018; average values

5.6 These are based on the following unit sizes (Table 5.2):

Table 5.2 Unit sizes

Dwelling Types	Sizes
2 Bed Flats	66
2 Bed Terraces	68
3 Bed Terraces	80
3 Bed Semis	80
3 Bed Detached	95
4 Bed Detached	112
5 Bed Detached	121

Source: National Space Standards; Developer schemes.

Costs

5.7 The following costs have been adopted (Table 5.3):

Table 5.3 Adopted costs

	Baseline	10% Externals	Total
Less than 80 Dwellings	£1,173	£117	£1,290
More than 80 Dwellings	£883	£88	£971
			£1,131
5% Contingency			**£1,187**

Source: Cushman and Wakefield (May 2017)

Costs uplifted by 5% from the Revised Local Plan and CIL Levy Viability Study

Professional Fees	6%
Contingency	5%
Marketing	3.50%
Purchaser Cost (Land)	6.80%
Finance	6.50%
Market Margin	20%
AH Margin	6%
Other S.106	£1,000 per unit

5.8 As can be seen from the screenshot, the construction costs have been taken as an average of all costs provided to Cushman and Wakefield.

5.9 There are then a number of additional costs which relate to items such as professional fees, marketing and finance.

Affordable housing revenue

5.10 The assumptions on the Affordable Housing revenue are set out in Table 5.4 below:

Table 5.4 Affordable Housing revenue

	Transfer Value
Value Area 1	**£131,000**
Value Area 2	**£120,000**
Value Area 3	**£113,000**
Value Area 4	**£120,000**
Melton Urban Area & SNs	**£85,000**

5.11 These are based on the policy testing work carried by Cushman and Wakefield. The values are blended revenues for an Affordable Housing unit taking into account the tenure split and the value areas. The C and W values in turn are based on a proportion of open market value, where Affordable Home Ownership is at 80% of open market value; where Affordable Rent is at 42% of OMV and where Shared Ownership is at 65% of OMV.

Residual values: the basis of commuted sums payable

5.12 In order to calculate indicate commuted sums for the Council sub markets, it has been necessary to assess residual values across a range of circumstances. This has been done by running a residual development appraisal model (Toolkit) on the basis of a notional one hectare site, at an assumed density of 30 dwellings per hectare.

5.13 The results are shown on the following page in Table 5.5:

Table 5.5 Residual values (notional one hectare site)

Value Areas	Percentage Affordable Housing					Differentials			
	0%	10%	20%	30%	40%	10%	20%	30%	40%
Value Area 1	£2.13	£1.95	£1.75	£1.57	£1.38	£0.18	£0.38	£0.56	£0.75
Value Area 2	£1.50	£1.35	£1.19	£1.04	£0.88	£0.15	£0.31	£0.46	£0.62
Value Area 3	£0.98	£0.86	£0.74	£0.62	£0.49	£0.12	£0.24	£0.36	£0.49
Value Area 4	£0.56	£0.50	£0.44	£0.38	£0.32	£0.06	£0.12	£0.18	£0.24
Melton Urban Area	£0.56	£0.41	£0.25	£0.10	-£0.06	£0.15	£0.31	£0.46	£0.62
SNs	£0.56	£0.41	£0.25	£0.10	-£0.06	£0.15	£0.31	£0.46	£0.62
Residual Values per One Hectare site (£ million)									

5.14 This shows a range of results – all expressed in terms of £ million per hectare.

5.15 It can be seen that the residual values (RVs) vary significantly between the Value Areas. For example, the RV at 40% Affordable Housing in Value Area 1 is over twice as high (£1.38 million) as in Value Area 4/Melton UA at nil Affordable Housing (£0.56 million).

5.16 Residual values look low in the Value Area 4 and Melton UA locations.

5.17 The right part of the table on the previous page sets out the RV differentials. These are the differences between different percentages of Affordable Housing. For example (Value Area 1) £180,000, which is the difference in RV between 0% Affordable Housing and 10% Affordable Housing.

5.18 As another example, the figure of £240,000 which is the difference between 0% Affordable Housing and 40% Affordable Housing in Value Area 4.

5.19 These differentials are key to setting a commuted sum figure as they represent the impact of Affordable Housing on the residual value of a scheme.

5.20 The table (Table 5.6) on the following page looks at the impact on a per unit basis. This takes the RV and divides it by the number of Affordable Housing units.

Table 5.6 Impacts on residual value per AH unit

10% AH	RV	No AH Units	Differ per Unit
Value Area 1	£0.18	3	£60,000
Value Area 2	£0.15	3	£50,000
Value Area 3	£0.12	3	£40,000
Value Area 4	£0.06	3	£20,000
Melton Urban Area	£0.15	3	£50,000
SNs	£0.15	3	£50,000
20% AH	RV	No AH Units	Differ per Unit
Value Area 1	£0.38	6	£63,333
Value Area 2	£0.31	6	£51,667
Value Area 3	£0.24	6	£40,000
Value Area 4	£0.12	6	£20,000
Melton Urban Area	£0.31	6	£51,667
SNs	£0.31	6	£51,667
30% AH	RV	No AH Units	Differ per Unit
Value Area 1	£0.56	9	£62,222
Value Area 2	£0.46	9	£51,111
Value Area 3	£0.36	9	£40,000
Value Area 4	£0.18	9	£20,000
Melton Urban Area	£0.46	9	£51,111
SNs	£0.46	9	£51,111
40% AH		No AH Units	Differ per Unit
Value Area 1	£0.75	12	£62,500
Value Area 2	£0.62	12	£51,667
Value Area 3	£0.49	12	£40,833
Value Area 4	£0.24	12	£20,000
Melton Urban Area	£0.62	12	£51,667
SNs	£0.62	12	£51,667

Averages				Say
Value Area 1			£62,014	£62,000
Value Area 2			£51,111	£51,000
Value Area 3			£40,208	£40,000
Value Area 4			£20,000	£20,000
Melton Urban Area & SNs			£51,111	£51,000
Melton Urban Area & SNs			£51,111	£51,000

5.21 This suggests (please see table at the bottom of the screenshot), indicative commuted sums in the range £62,000 per unit (Value Area 1) through to £20,000 per unit (Value Area 4).

5.22 These figures represent the financial impact of exchanging one Affordable Housing unit on site for one Market unit on site and hence in turn, represent, an equivalent payment as a commuted sum.

5.23 The figures also represent the sum of money that the Council would require, across the range of Value Areas, to develop one Affordable dwelling. This is because the figures account of all sides of the residual valuation equation, namely values and costs for Market Housing and values and costs for Affordable Housing.

5.24 The figure sought, therefore covers both the land element for an Affordable dwelling, as well as the financial gap between what a housing association would pay for an Affordable unit and the cost of providing it.

Examples in practice

5.25 The application of the figure is straightforward. Set out below are some hypothetical examples (Table 5.6):

Table 5.6 Examples for calculating commuted sums

Examples					
	Value Area 1		Value Area 2		Melton UA & SNs
	12 Units		20 Units		15 Units
	40% AH		32% AH		10% AH
	12		20		15
	0.4		0.32		0.1
	4.8		6.4		1.5
	£62,000		£51,000		£51,000
Comm Sum	£297,600	Comm Sum	£326,400	Comm Sum	£76,500
	Value Area 3		Value Area 4		
	25 Units		85 Units		
	25% AH		15% AH		
	25		85		
	0.25		0.15		
	6.25		12.75		
	£40,000		£20,000		
Comm Sum	£250,000	Comm Sum	£255,000		
NB: % here are hypothetical & subject to policy changes					

5.26 As one example (Value Area 1), for a scheme of 12 units, with a 40% Affordable Housing contribution, 4.8 units would be Affordable.

5.27 The payment in lieu or commuted sum would then be £297,600 (£62,000 x 4.8 units)

5.28 As another example (Value Area 2), for a scheme of 20 units, with a 32% Affordable Housing contribution, 6 units would be Affordable.

5.29 The payment in lieu or commuted sum would then be £326,400 (£51,000 x 6.4 units).

5.30 These figure can be applied to any scheme, although of course the sum payable will be subject to a viability test taking into account the land value benchmark, as discussed in a previous chapter.

Commuted sums set by unit type and by unit type on a square metre basis

5.31 I have utilised the baseline analysis to develop indicative commuted sums on a per unit: per dwelling type basis and on a per unit: per sq m basis.

5.32 The table (Table 5.7) on the following page sets out the indicative commuted sums. All figures as previously are by Value Area in line with the C and W study.

Table 5.7 Commuted sums per unit and by square metre by value area

Dwelling Types	Unit Size	Value Area 1		Value Area 2		Value Area 3		Value Area 4		Melton Mowbray		SNs	
		Per Unit	Per Sq M	Per Unit	Per Sq M	Per Unit	Per Sq M	Per Unit	Per Sq M	Per Unit	Per Sq M	Per Unit	Per Sq M
1 Bed Flats	45	£36,000	£800	£29,000	£644	£23,000	£511	£12,000	£267	£29,000	£644	£29,000	£644
2 Bed Flats	64	£51,000	£797	£42,000	£656	£33,000	£516	£16,000	£250	£42,000	£656	£42,000	£656
3 Bed Flats	76	£60,000	£789	£50,000	£658	£39,000	£513	£19,000	£250	£50,000	£658	£50,000	£658
2 Bed Terraces	68	£59,000	£868	£44,000	£647	£35,000	£515	£17,000	£250	£44,000	£647	£44,000	£647
3 Bed Terraces	78	£62,000	£795	£51,000	£654	£40,000	£513	£20,000	£256	£51,000	£654	£51,000	£654
4 Bed Terraces	106	£84,000	£792	£69,000	£651	£54,000	£509	£27,000	£255	£69,000	£651	£69,000	£651
3 Bed Semis	78	£62,000	£795	£51,000	£654	£40,000	£513	£20,000	£256	£51,000	£654	£51,000	£654
4 Bed Semis	110	£87,000	£791	£72,000	£655	£56,000	£509	£28,000	£255	£72,000	£655	£72,000	£655
3 Bed Detached	96	£76,000	£792	£63,000	£656	£49,000	£510	£25,000	£260	£63,000	£656	£63,000	£656
4 Bed Detached	114	£91,000	£798	£75,000	£658	£58,000	£509	£29,000	£254	£75,000	£658	£75,000	£658
5 Bed Detached	125	£99,000	£792	£82,000	£656	£64,000	£512	£32,000	£256	£82,000	£656	£82,000	£656

5.33 The table allows the Council to collect sums on a per unit basis (by dwelling type) or on a per square metre basis.

5.34 Examples are given below (Tables 5.8 and 5.9) , beginning with the commuted sum payable on a per dwelling unit and type basis:

Table 5.8 Commuted Sum by dwelling

Per unit by Dwelling Type basis			Commuted Sum
Scheme	15 dwellings		
V Area 1	40% AH		
Affordable Homes	6 units		
Example			
Terraces (2 bed)	3	£59,000	£177,000
Semis (3 bed)	2	£62,000	£124,000
Detached (4 bed)	1	£91,000	£91,000
	6		
Commuted Sum			£392,000

5.35 Then the commuted sum payable on a per square metre per dwelling basis:

Table 5.8 Commuted Sum per square metre

By Dwelling Type & Sq M basis				Commuted Sum
Scheme	25 dwellings			
V Area 2	32% AH			
Affordable Homes	8 units			
Example		Size	Rate per Sq M	
Terraces (2 bed)	4	68	£647	£175,984
Semis (3 bed)	3	78	£654	£153,036
Detached (4 bed)	1	114	£658	£75,012
Commuted Sum				£404,032

6 Conclusions and recommendations

Summary and conclusions

6.1 This report has looked at the issue of commuted sums and their potential application to the Melton Borough area. The Council are concerned to have supporting information for their emerging SPD on Affordable Housing.

6.2 This report has looked at the current policy approach in the Borough, the principles of viability and the delivery of commuted sums, contemporary prcatice within Leicestershire and across England, and has made recommendations on an appropriate approach for Melton Borough, taking into account the advantages and disadvantages of different approaches.

Viability and commuted sums

6.5 It is important to stress that commuted sums, even where expressed as indicative figures or formulae, are still subject to a test of viability, not least because land value benchmarks sometimes exceed residual values for some sites.

6.6 This means that although an indicative sum can be set out (as in Chapter 5 above), a 'back stop' mechanism is sometimes needed where existing use value becomes an issue; for example with brown field sites with a high value commercial use.

6.7 Under these circumstances, the indicative sums may not be viable to pay, or at least only partially viable. The Council may then decide, particularly if it is a significant or substantial site, to test it on a bespoke basis.

6.8 There are a number of model available to do this, including the Council's own Toolkit. This was developed for the initial (Three Dragons) policy development work and included default data on prices, costs and Affordable Housing revenues. This could be updated to include current data.

Approach to commuted sums

6.9 Having looked in some detail at the options for setting a commuted sum, it is clear that there is by no means a consistent approach.

6.10 There are a number of important dimensions to consider including the number of variables to consider (some approaches use simply values, whilst others use costs as well), whether to adopt a formulaic approach or a site by site appraisal approach and if, with a formula, whether to base this on a unit or per square metre basis.

6.11 Simplistic appraches based just on values for example, have the drawback that the cost side of the equation is not taken into account. Gap funding approaches are used although these also tend not to take costs into account. None of these approaches provide equivalence; i.e put the land owner in the same position whether there is an on-site or a commuted sum Affordable Housing contribution. On this basis it is believed that inequities may result between land owners providing site where an on-site contribution is agreed, and others, where a commuted sum is agreed. Fairness and transparency should be sought.

6.12 For this reason, the approach recommended is one which delivers equivalence by using a residual valuation approach and which generates indicative commuted sums on a per unit basis. This

approach is consistent with other local approaches (Charnwood BC were recommended this approach) as well as commuted sum approaches from further afield across England.

Affordable Housing

6.13 The tenure of Affordable Housing is key to the calcuation of commuted sums. It is important to recognise that central government have moved the position significantly since 2010 from traditional Social Rent to Intermediate Affordable including products such as Affordable Rent, through Starter Homes, and more recently in the updated NPPF (July 2018) towards affordable home ownership.

6.14 The position may move again, as indeed may the Council's own assessment of housing needs. If this is the case, it may change the revenue side of the equation such that the commuted sums sought could increase or indeed, decrease. This variable therefore needs tracking over time.

Community Infrastructure Levy (CIL)

6.15 The Council has a CIL Preliminary Draft schedule for infrastructure other than Affordable Housing:

6.16 This is to cover items of (physical, social and environmental) infrastructure covered in the Council's Regulation 123 list.

6.17 Whilst, the Affordable Housing indicative commuted sums set out in this report stand, the impact of CIL, alongside the impact of Affordable Housing may need to be considered in situations where, as previoulsy highlighted, the land value benchmark is high.

6.18 The diagram below shows an example where a 20% Affordable Housing contribution would be viable:

AH	RVs				LVB	CIL
10%						
20%						
30%						
40%						

6.19 In the diagram, the land value benchmark woule mean that (in the absence of CIL) a 30% Affordable Housing contribution would be viable (either as a commuted sum or on-site); however with the impact of the LVB and the CIL, a 20% Affordable Housing contribution would be viable.

Recommendations

- That the Council set out the 'back stop' position for commuted sums, where the scheme is agreed not to be viable to deliver the indicative commuted sum. This would best be dealt with through an update of the initial Melton BC Toolkit, provided as part of the Leicestershire Affordable Housing policy development work (2009-10);
- That the Council adopt an indicative commuted sum approach, based on high level testing and a residual valuation approaches which takes account of all viability variables, namely gross development value, Affordable Housing revenue, development costs and margin;
- That this approach is updated annually based on an indexed house prices (Land Registry) and construction costs (BCIS – Building Cost Information Service from the RICS – Royal Institution of Chartered Surveyors);

Appendix 1 Affordable Housing Delivery and Commuted Sums

Questionnaire Survey

Background

Melton Borough Council is currently developing supporting documentation to assist with the delivery of the emerging new Local Plan (2011 – 2036). It is anticipated that the Plan will be adopted later this year (2018).

Key to the implementation of the Plan is the delivery of an Affordable Housing and Housing Mix Supplementary Planning Document (SPD). This is now under development.

An important aspect of the SPD relates to commuted sums which provide an alternative approach to on site Affordable Housing development where

it is decided that a payment-in-lieu is a fair and efficient means of contribution.

The Council wish to have supporting information for the SPD which can help to deliver Affordable Housing through off site contributions.

This questionnaire seeks to understand more about how this might work, based on the experiences of other (Leicestershire and East Midlands) local authorities.

It would be much appreciated if you could complete the following few questions which relate to the subject area.

1 What threshold (number of units/site size) for Affordable Housing has your authority adopted? Is there a specific reason for this?

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2 What general approach does your authority take to the requirement for commuted sums?

For example, is there a formal policy, SPD/G or is this done on a site-by-site basis?

If there is a formal policy/SPD/G please can you provide a reference or a link?

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3 Does your authority have a formulaic approach and how is this set up (for example by sub market, dwelling type, sum per square metre)

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4 If there is a formulaic approach, how does it deal with situations where schemes are argued not to be viable?

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5 What is the formula based on? For example, scheme revenue, indicative costs, land value or anything else?

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6 How generally successful are you finding your approach to the collection of commuted sums? What might be done to improve the process?

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THANK YOU VERY MUCH FOR YOUR ASSISTANCE.

AJ Golland

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