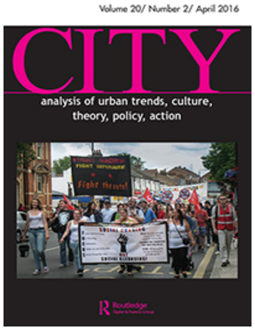

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Complete control

Developers, financial viability and regeneration at the Elephant and Castle

Jerry Flynn

Regeneration has for several years been the favoured term of developers and local authorities for house building programmes in London. Regeneration promises new homes in rejuvenated neighbourhoods. This article tells of how such promises were instead used to lever the residents of one south London council estate, the Heygate, from their homes, leaving the benefits of regeneration for the more affluent to enjoy. It is also a case study of how private developers profit from regeneration, without building homes that most people could actually afford to either rent or buy, and how they evade a local authority's planning requirements for affordable housing by means of secret financial reports, so-called 'viability assessments'. Finally it briefly recounts how some local communities are starting to challenge this so-far unchallenged power that puts developer profit above the need for truly affordable housing.

Key words: financial viability assessment, regeneration, developers, council estate, affordable housing, land value, displacement

Introduction

The Elephant Amenity Network (EAN) is a community group at the Elephant and Castle, South London, set up in 2008 to get a better deal out of the £1.5 billion regeneration of the area. A major EAN concern was a lack of truly affordable housing; indeed, the Elephant's regeneration entailed the loss of the best kind, council housing and its replacement by housing that was affordable in name only. EAN therefore started the 35% campaign,[1] which had the modest ambition of holding the local authority, Southwark Council, to the promise of its local plan, that all new large developments would have a minimum of 35% affordable housing.

Affordable housing has three categories—social rented, affordable rented and intermediate housing.[2] The cheapest is social rent, most familiar as council housing. Housing Associations also provide social rent, but since 2011 they have been replacing it with affordable rent—at up to 80% of market rent—and so entirely unlike social rent which is determined by a statutory formula, largely linked to local incomes. Housing associations also provide intermediate housing, or part buy/part rent, for those who can pay more than social rents.

There is an almost invariable obligation on developers to deliver a proportion of new housing as affordable, but it is commonly avoided by a simple expedient—show that your scheme is financially unviable if it has affordable housing, by using a financial viability assessment (VA). Crudely, a VA subtracts the cost of a development from how much it will make; what is left is the developer's profit and if there is not enough then the scheme is 'unviable'; a dependable consultant decides how much profit is 'enough'. A developer-friendly planning regime, which emphasises viability as a key to sustainable development and allows developers a right of appeal against a planning refusal (and the support of the Mayor, in the case of London) means that any capable developer will get a VA[3] rather than have to build affordable housing. We will show how this happened on the Heygate estate, at the Elephant, what we did to combat it, what we found out and what other campaigners can learn from our experience.

'Regenerating' (removing) the Heygate estate—and other developments in Southwark

The Heygate was a council estate of 1200 homes, built in the early 1970s. It was earmarked for redevelopment in 1998 and various regeneration options were originally considered, only one of which was entire demolition. Notwithstanding a MORI Poll of residents[4] which found that there was 'no clear consensus on which of the options for future development should be taken' and that 63% of the residents wished to remain in a council home on the estate, Southwark Council decided on demolition. In 2007, Southwark adopted Australian developer Lend Lease as its development partner, a Regeneration Agreement[5] was signed in 2010, and in 2012 planning applications[6] were submitted for the demolition of the estate and its replacement by over 2400 new homes, including 600 or so affordable homes.

Lend Lease's development was not intended to rehouse any of the former residents, who had nearly all been 'decanted' in 2007–2008. They had consisted of council tenants, leaseholders and 'non-secure tenants', the last typically from black and ethnic minority backgrounds, migrants and asylum seekers amongst them. The secure council tenants (but not the non-secure tenants) were to be rehoused in new homes on so-called 'early housing sites', while the leaseholders would get financial compensation for their homes. In the event the early housing sites[7] were not built in time and most tenants were rehoused in other council housing stock in Southwark (Figure 1). Most leaseholders, on the other hand, moved away from the area, in many cases out of central London, because of inadequate compensation (Figure 2). No central record was kept of what happened to the non-secure tenants, hence it's impossible to track their displacement movements. Only 45 Heygate households got any kind of new home.[8]

Although Heygate residents were not being housed in Lend Lease's development it was still required to provide 25% affordable housing—about 600 homes, half social rented and half intermediate. This had been negotiated down in the Regeneration Agreement from the 35% affordable housing the local plan required, but nonetheless Lend Lease had still to supply a VA to justify the reduction and engaged 'global real estate services provider' Savills for the task. The VA would have to justify not only the reduction of the 430 social rented units down to 300, by virtue of the Regeneration Agreement, but also a further reduction down to 79[9] units as Lend Lease now proposed replacing most social rented flats with affordable rent flats, at 50% market rents (in the Heygate's SE17 postcode 50% market rent would have meant an average weekly rent across all unit sizes of £194, when the median weekly income of a council house tenant was £174).[10] After the VA was appraised for Southwark Council's planning officers by the District Valuer Service (DVS), the officers duly recommended approval of the applications, stating that the 'indicative viable level' of affordable housing was a meagre 9.4%, a figure Lend Lease said that it would make up to 25%, so as to honour the

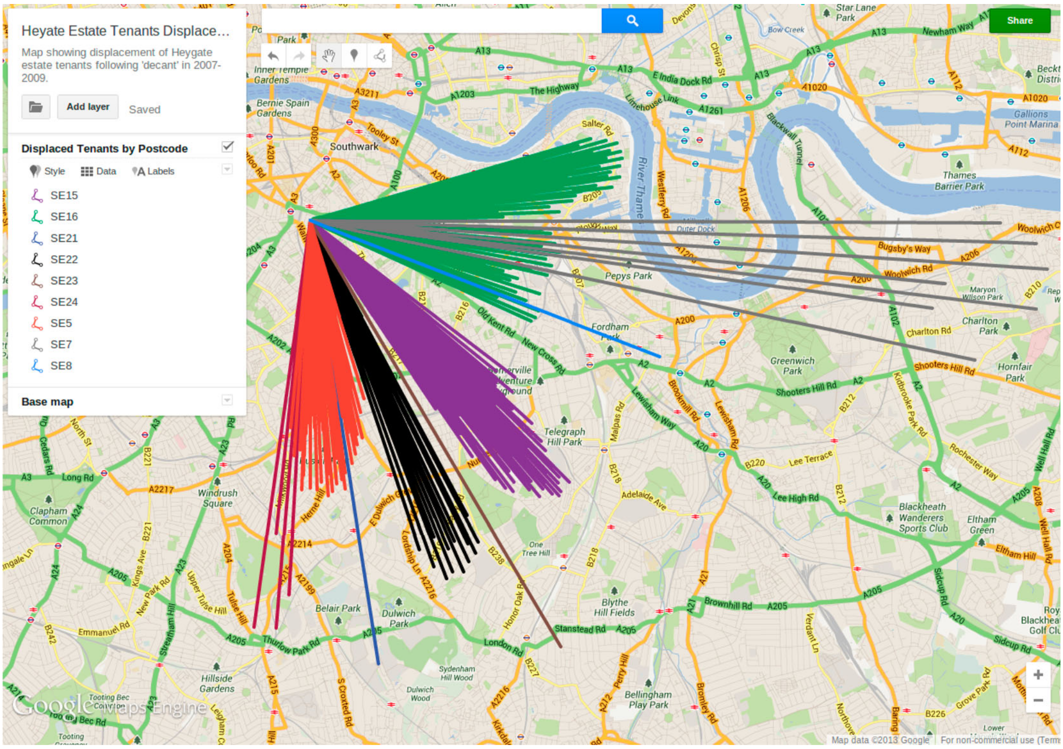

Figure 1 Map of displaced Heygate council tenants (Source: http://35percent.org/blog/2013/06/08/the-heygate-diaspora/).

Regeneration Agreement. Southwark Council's Planning Committee was persuaded and approved the applications, including only 79 social rented units.[11]

Despite the shortfall in affordable housing, the Planning Committee approval was typical, as Table 1 demonstrates. All these selected major developments in north Southwark, dating from 2008, were submitted with VAs that were accepted as proof that affordable housing requirements could not be met. The schemes' total of over 1300 units have an estimated total value of £3.4 billion, but barely provide 5% affordable housing in equivalent value terms—a vivid illustration of how much developers owe to VAs.

Reluctant revelations on financial viability

The VA was so confidential that those not allowed to see it included the Planning Committee. The only public information was limited to the planning officer's report, endorsing the VA's conclusions about the development's unviability. The DVS appraisals that the planning officers depended upon for their recommendations were also confidential. Predictably, Southwark Council refused a Freedom of Information (FOI) request for the VA when it was made by Heygate leaseholder Adrian Glasspool. The request was referred to the Information Commissioner's Office (ICO) who ordered Southwark to disclose the information. Southwark, supported by Lend Lease, unsuccessfully appealed,[12] and the VA,[13] after some redactions relating to Lend Lease's business model, was released in May 2015, three years after the original request.

By the time the VA was released, EAN had redacted versions of the two DVS

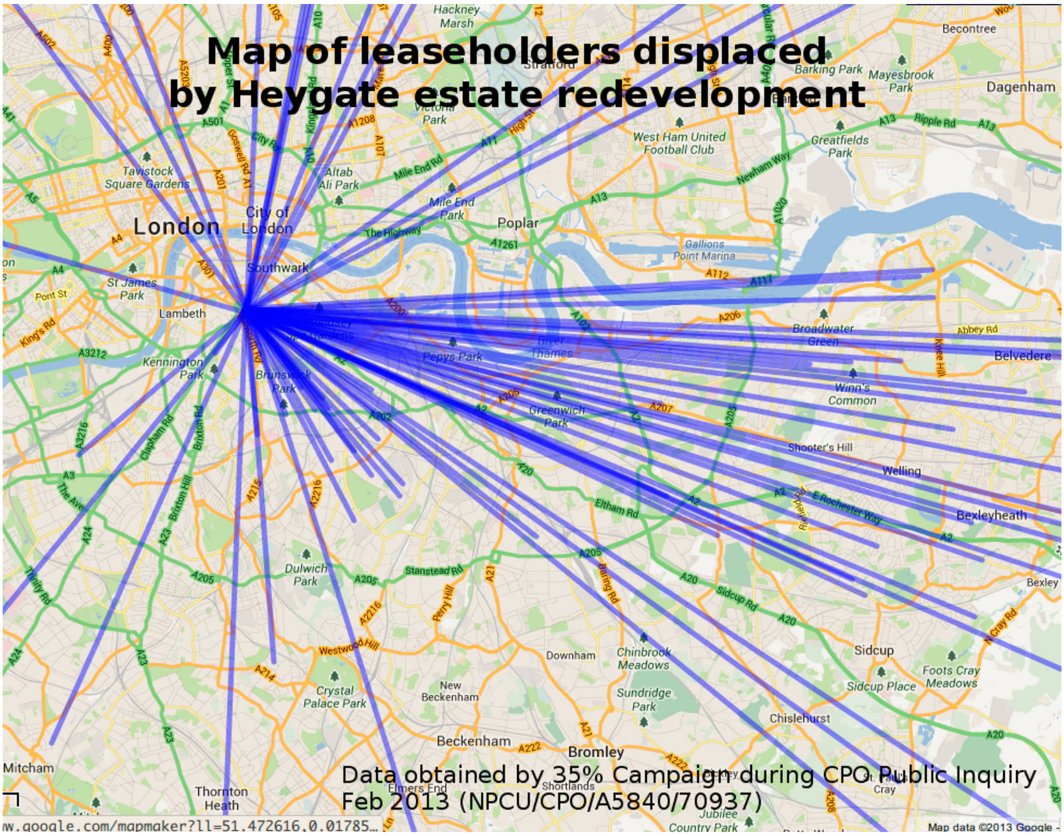

Figure 2 Map of displaced Heygate leaseholders. (Source: http://35percent.org/blog/2013/06/08/the-heygate-diaspora/ (data submitted by Southwark Council at the February 2013 Heygate CPO Public Inquiry))

appraisals,[14] also following FOI requests, and by examining all three documents we saw how the VA practically guaranteed that the scheme's affordable housing was reduced, through both the method used to construct it and the latitude allowed for various value judgements.

First, the scheme that is tested for viability does not offer 35% affordable housing, so there is no exploration of how this might be

Table 1 Selection of major development schemes since 2008 in north Southwark

	Estimated gross development value (GDV) £ million	Affordable housing offer £ million	% of total	Total units in development
One Blackfriars	700	29	4	274
Baby Shard Trilogy	300	18.8	6	148
Tribeca Square	250	1	0.4	273
Bankside Quarter	1000	65	6.5	500
185 Park Street	300	30	10	163
South Bank Tower	620	27	4	173
One the Elephant	230	3.5	1.5	284
TOTAL	3400	174.3	5.12	1320

Sources: Planning documents; media real estate reports of GDV.

achieved. The scheme tested was instead one devised by Lend Lease, with an affordable housing baseline of 25% and so there was never any possibility that it would deliver 35%.

Second, the scheme is tested by Lend Lease agents, Savills, not tested by Southwark Council. Savills make the assumptions and decide on the values used in the VA, including the measure of a viable scheme, the benchmark. That this turned out to be the desired profit created a virtuous circle from Lend Lease's viewpoint: the higher the profit, the higher the benchmark, the less likely the scheme will prove to be viable, creating more scope to diminish the affordable housing.

The only disincentive to exploiting this situation was that the DVS would contest the VA's conclusions and that Southwark Council would reject the planning application. There was little chance of the latter; Southwark had already accepted 25% in the Regeneration Agreement and it needed to show some visible progress on a development that was then 15 years old, so corporate and peer/party pressures on the committee majority were strong. All sides were also aware that Lend Lease could appeal against any rejection and be favourite to win; alternatively, it could ask the Mayor to 'call-in' the application and reverse the decision.

For its part the DVS did eventually concur with the VA, stating that 'the scheme on a current cost basis is clearly unviable and would not be built with this level of Affordable Housing',[15] but not before several disagreements with Savills, which if resolved in a different way may have led to a different conclusion. These differences included how much would be made from the residential units, what was the value of the land, what constituted a 'reasonable profit' and what the benchmark of viability should be.

The VA estimated that the residential value would be £598 per sq. ft, based on local 'comparable' sales evidence.[16] This included sales of properties a long way in every respect from the concierge-serviced luxury towers being built at the Elephant, such as a two-bed ex-council flat on an estate straddling the Walworth/Camberwell borders.[17] The DVS described the sales values as 'too conservative' saying that 'much of the local sales evidence is not comparable to what is proposed' and it 'does not give an idea of what may be achieved following redevelopment'. The eventual average sale prices of £1012 per sq. ft[18] for an early phase of the redeveloped Heygate (re-christened Elephant Park) proved his point.

Land value is a critical and contentious factor in determining viability; broadly the more that is paid for land the less there will be for affordable housing. The VA arrived at four different land values:

(1) £37.3 million (the land's worth if it continued in its existing use as a housing estate);[19]
(2) £48.5 million (the land's worth if a developer were willing to pay a premium price);[20]
(3) £72 million (based on sales of comparable sites);[21]
(4) £48 million (the actual purchase price paid by Lend Lease).[22]

The VA settled on £48 million,[23] but the District Valuer disagreed and came up with a fifth figure—£26.4 million.[24]

The VA also settled on 25% as profit on costs (20% Internal Rate of Return—IRR) and used these figures as the benchmark, based on a land value of £48 million.[25] As profit on costs this is 5% higher than the 20% in the Regeneration Agreement, but the VA does not address the difference, instead justifying the 25% figure on two counts—that it is what everyone else is getting ('having regard to our own development experience ... throughout London')[26] and it's what was required to secure bank funding.[27] The DVS was unimpressed and says 'I do not adopt the profit benchmark that Savills have adopted ... '[28] and 'I would like to see some evidence provided to benchmark these levels of returns as my understanding is that most development schemes ... average out below 15%'.[29]

The significance of all these differences of opinion about the scheme value, land value, profit and benchmark are brought into focus by the DVS's initial conclusions, in his first appraisal. He suggests a profit level of 15–18% and sets his own benchmark of 16% IRR.[30] He points to the 'significant impact on profitability' of the modest 5% rise in sales value.[31] He states that the scheme cannot support 'policy compliant provision', but makes two suggestions, one that an 'acceptable target rate of profit' is identified before there is any change to the tenure type in affordable housing, for example, before social rented is dropped,[32] and second that there is a review mechanism to recoup lost affordable housing if the scheme is more profitable than anticipated[33] (a suggestion considered but effectively rejected by Southwark Council).[34]

The DVS also produced 28 different scenarios, varying the input values to generate a range of outputs, including scheme profit, profit on cost, scheme IRR.[35] The first 14 scenarios all have redacted outputs, but those for the last 14 reveal the scheme profits, in cash and percentage terms and these paint a quite different picture of the viability of the scheme from that presented by officers to the Planning Committee, which emphasised that a viable scheme could only deliver 9.4% affordable housing.[36] Eleven of the scenarios deliver a profit on cost above the 20% agreed in the Regeneration Agreement and six of these deliver profit on cost above the VA's 25% benchmark figure. All these scenarios are run with 25% affordable housing and critically all include social rented housing.

Three scenarios are run with 35% affordable housing, one of which, scenario 26, gives a profit on cost of 18.74% and £227.275 million with some reduction in social rented housing, a 5% improvement in residential sales values and the lower land value of £26.4 million. This scenario on its own does not demonstrate that the scheme could support 35% affordable housing, but it does demonstrate that by reducing the profit benchmark, increasing sales expectations and taking a lower land value there was a possibility of doing so.

Several other points about scenario 26 deserve emphasis; first, it is based on the scheme as presented by Lend Lease and does not posit any major physical changes; second, while it is based on a 5% increase in the expected residential sales value of £598 per sq. ft, nearly twice this, £1012 per sq. ft, was to be realised in an early phase; third, that it still delivers a handsome profit of £227 million.

We learnt from the DVS's second appraisal that there were 'a series of meeting [*sic*] to discuss the various differences in order to reach more of a consensus'.[37] The consensus reached included using the VA's private residential sales figures—presumably dropping the 5% sales 'improvement'—and the higher VA benchmark land value of £48 million.[38] There is no longer any mention of identifying an acceptable profit rate before considering changes to affordable housing tenure, to allow further scenarios; instead, affordable rent at 50% market rent and higher qualification thresholds for half the intermediate housing are introduced. The DVS does maintain an objection to development and project management fees,[39] having called this potential additional profit.[40]

In his final conclusion, the DVS identifies the profit gap as £65 million, but believes this would be reduced to £30 million if a lower land value and a lower IRR of 17.5% were used.[41] He also repeats his first appraisal conclusion that 'the scheme *as currently proposed* does not provide a policy compliant affordable housing provision' (our emphasis),[42] but does so without pursuing any further the input changes that might have helped bridge the viability gap suggested in the first appraisal. He makes no mention of 9.4% as being the 'indicative viable level of affordable housing' as was described to the Planning Committee, but repeats the recommendation for a review mechanism.

Summary of our views

- The major purpose of the Heygate VA was to demonstrate that Lend Lease's scheme could not supply the 25% affordable housing, secured in the Regeneration Agreement, and remain viable; the further aim was to justify replacing social rented housing with affordable rent. It was not to examine or explore other options that could increase this to 35%.
- The viability of the scheme was measured by its profit and it was failure to reach the benchmark level 25% profit on cost/20% IRR that made the scheme unviable, not the prospect of the scheme making a loss.
- The inputs into the viability calculations could have been varied (e.g. the land value, sales values) and profit reduced to improve the viability of the scheme and deliver more affordable housing.
- The unredacted DVS scheme scenarios show that schemes with 25% affordable housing, including social rented, could be viable. They delivered profits between £260 million and £364 million and exceeded either the 25% profit benchmark used in the VA or the 20% profit agreed in the Regeneration Agreement.
- The recommendation to have an effective review mechanism that could have increased the amount of affordable housing or the cheaper affordable tenures was ignored without reasonable justification.

None of this amounts to conclusive proof that this particular scheme could have been policy compliant and delivered 35% affordable housing. Nevertheless, we believe that the chance of achieving 35% was not as hopeless as Southwark's Planning Committee was led to believe and that there was also a much greater possibility of keeping social rented housing. Lend Lease and Savills though had effective and de facto unchallenged control of the viability process and did not allow those options to be explored.

Instead, the committee was presented with a bald 9.4% affordable viability answer, which discouraged all questioning of the VA, made Lend Lease look good in offering 25% (while leaving unexplained how 25% could be achieved) and undermined any arguments in favour of a review mechanism. It represented a comprehensive triumph of the developers' need for profits over the local community's need for homes it can genuinely afford to live in.

Conclusion

The disclosure of the Heygate VA has provided a window into the viability process and shows how contingent it is on uncertain 'facts', opinion and argument. It also shows how a closed and secret part of the planning process has become the determining factor in major planning decisions, while falling under the control of developers, with great gains to them, but huge loss to the public.

But there has been a reaction. The £1.2 billion Shell centre redevelopment,[43] the 10,000 home Greenwich Peninsula development[44] and the tower-block redevelopment of Bishopsgate's Goodsyard[45] all feature local campaigns that have thrust VAs centre stage. This has caused the *Estate's Gazette* to lament that a new 'sophisticated breed of campaigner' through their understanding of the planning system 'throw some real spanners in the works of some of London's biggest schemes'.[46] Controversial estate regenerations, such as that of the Heygate's sister estate, the Aylesbury,[47] also rely heavily on VAs to justify themselves.

Local authorities have therefore been forced to take action—Islington,[48] Greenwich,[49] Lewisham[50] and Southwark[51] are all toughening up their approach to VAs (although only a cautious welcome is advisable until their resolve is tested by a recalcitrant developer). The London Assembly has also turned its attention to the question, inviting both developers and campaigners to give evidence to its Planning Committee.[52]

So campaigners have made creditable gains in dragging what was becoming a disreputable part of the planning process into the light of day, with the help of sympathetic planning professionals, academics, lawyers and journalists. But we have not forced developers to abide by local affordable housing requirements and an understanding of viability is needed if there is to be any hope of doing so. The good news is that campaigners have demonstrated that the layperson can understand it only too well, when allowed to see the assessments. Unsurprisingly, profit turns out to be one big determining factor of how much affordable housing is built and mounting a serious challenge against the developers' assumption that they are due whatever they claim is the campaigners' next battle.

Disclosure statement

No potential conflict of interest was reported by the author.

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