Guidance Note

Affordable housing financial contributions on small sites
(2- 9 homes)

November 2024

Contents

LONDON BOROUGH OF MERTON

1. Purpose of the guidance note

1.1 This guidance note aims to assist in the delivery of affordable housing requirements set out in Merton's Local Plan Strategic Policy H11.1: *Housing Choice*, concerning how development appraisals or other agreed methods will be used by the council in calculating financial contributions for small development schemes (2-9 homes).

1.2 Merton's Local Plan (hereby referred to as the Plan) supporting text contained at paragraph 11.1.24 which states that *…..we will publish guidance to assist in the delivery of the affordable housing requirements set out in Strategic Policy H11.1 for schemes of 2 to 9 units, including how development appraisals or other methods agreed in writing with the council will be used in calculating financial contributions for these schemes*

1.3 A key principle set out in the Plan paragraph 11.1.23 concerning the calculation of financial contributions is that: *off-site provision or in lieu financial contributions secured via legal agreements should provide no financial benefit to the applicant relative to on-site provision.*

1.4 It is important to also note that the affordable housing provision requirement applies to gross rather than net development, that is the total number of homes in the approved completed scheme within the planning application site boundary.

1.5 This guidance note advises on the tariff approach which applicants can use in calculating financial contributions for small developments (2-9 homes). The tariff approach is underpinned and consistent with the Plan.

1.6 Advantages of the tariff approach include the following:

- Speeds up decision making for small sites.
- Provides certainty and transparency regarding the affordable housing financial contribution amount required from small sites.
- Simpler to operate in practice.

1.7 Where an applicant asserts that the full tariff would render their development proposals as unviable, the council will require the applicant to submit a financial viability assessment in accordance with the Plan and paragraphs 11.1.25 and 11.1.26.

1.8 The council does not require these affordable housing contributions to be paid up front. Any affordable housing financial contributions would be payable prior to occupation of the development.

2. Tariff approach details and application

2.1 A tariff or levy approach for securing financial contributions for small sites applies per home provided in a development. The tariff is consistent with the approach to determining payments set out in the Plan and paragraphs 11.1.25 and 11.1.26.

Tariff structure - Amounts payable per home in scheme

2.2 The council commissioned a separate study to identify the small sites tariffs outlined in Tables 2.3.1 and 2.3.2 below. The 2-9 homes tariff system aligns with Merton's existing two Community Infrastructure Levy (CIL) charging zones (see map at Appendix 2) namely: Charging Zone 1 (higher value zone) and Charging Zone 2 (lower value zone). Both tables set out the amounts payable per home in a development scheme in the two charging zones.

2.3 The study took a conservative approach toward contributions, seeking to settle on figures which are deliverable borough wide. Using Merton specific information data (for example residual land values, property sales values and planning obligations), the study determined that across the borough a financial contribution of £15,000 per home in the lower CIL Charging Zone 2 and £36,000 per home in the higher CIL Charging Zone 1 would be viable (see map in Appendix 2).

Table 2.3.1 – Lower CIL Charging Zone 2 (£15,000 per home)

Number of homes	2	3	4	5	6	7	8	9
No. of AH homes.	0.4	0.6	0.8	1	1.2	1.4	1.6	1.8
Payment in lieu amount per **every home** in scheme.	£30,000	£45,000	£60,000	£75,000	£90,000	£105,000	£120,000	£135,000

Table 2.3.2 – Higher CIL Charging Zone 1 (£36,000 per home)

Number of homes	2	3	4	5	6	7	8	9
No. of AH homes	0.4	0.6	0.8	1	1.2	1.4	1.6	1.8
Payment in lieu amount per **every home** in scheme.	£72,000	£108,000	£144,000	£180,000	£216,000	£252,000	£288,000	£324,000

2.4 The tariff operates on the basis of being payable for each home delivered in a development, rather than the number of homes that the Plan policy would have sought as on-site affordable housing. For the avoidance of doubt, the payment in lieu amount is the total amount per scheme. Therefore, a scheme proposing two homes (gross) will be required in total to pay £30,000 payment in lieu if it is in charging zone 2 or £72,000 in charging zone 1.

2.5 As the amount payable under a tariff approach is fixed, rather than being site-specific, the amount payable on individual developments is likely to be lower than the amount that could have been secured using the viability appraisal approach set out in the Plan. This is because the tariff approach moves away from a site-specific calculation of the amount payable to a broad average figure. The tariff amounts are set at a discount to the maximum potential rate, in a bid to minimise the number of viability submissions.

3. Financial viability assessments

3.1 The tariffs will apply on a 'subject to viability' basis if applicants consider that payment of the tariff (either in full or part) would render a proposed development as unviable. In cases where applicants assert that the full tariff would render their development proposals as unviable, they would need to provide evidence to support this assertion in the form of a financial viability assessment, requiring full residual valuations.

3.2 In these circumstances, the council would expect applicants to demonstrate their viability case using the method set out in the Plan (and paragraphs 11.1.25 and 11.1.26) and adopt the 'two residual valuations' approach to calculating the payment in lieu. Please refer to a detailed financial viability assessment example illustrating this approach contained at Appendix 1 of this guidance note.

3.3 Calculations should always relate to the specific scheme which is the subject of the planning application and not a hypothetical alternative scheme. Financial viability assessments will determine:

a) The overall level of affordable housing that is viable – if a policy compliant level is considered unviable and
b) The amount of a payment in lieu.

3.4 All financial viability appraisals should be accompanied by the following:

a) An executive summary setting out the key findings and conclusions of the financial viability appraisal. This should clearly explain the applicant's reasoning why it would not be economically viable for the proposed development to comply fully with the Plan and Mayor of London requirements.

b) A fully working software model that can be tested. The council will accept alternative models (e.g. Microsoft Excel based appraisals) provided they explicitly show the calculations and can be fully interrogated, and the inputs varied.

c) A table that clearly sets out all the assumptions, inputs, benchmarks finally agreed for the application stage appraisal that together would enable any competent person to rerun the application viability appraisal and get the same result.

3.5 In accordance with paragraph 58 of the National Planning Policy Framework financial viability appraisals will be made publicly available.

3.6 If changes are made to the proposal during the process of assessing the application that could affect viability or there is a material change in circumstances to the scheme, Merton Council will expect to receive a revised viability appraisal.

3.7 The council may need to procure external support for reviewing viability appraisal submissions and applicants will be expected to cover the cost of independent viability assessment(s). This approach may also be more appropriate for developments above the ten homes threshold where the council has agreed that exceptional circumstances warrant a payment in lieu rather than on-site affordable housing delivery. It may also be appropriate for schemes involving very large homes with high values which sit outside the normal range of sizes and values.

4. Legally securing affordable housing financial contributions from small sites

4.1 The small sites contribution will be secured by Unilateral Undertaking (UU). The UU must be secured before the planning application is determined. The council does not require these affordable housing contributions to be paid up front. Any affordable housing financial contributions would be payable prior to occupation of the development.

4.2 Agreement on the 'Heads of Terms' for the UU must be reached before their detailed negotiation can begin. The process to achieving agreement on 'Heads of Terms' is as follows:

a) The applicant will be expected to sign a 'Letter of Agreement' prior to their application being validated. This 'Letter' will be on the council's website.

b) A 'Template Small UU' will be available on the council's website, containing 'Heads of Terms' to be expected in any final Undertaking reached prior to decision. That template will help guide applicants of what to expect from small site Affordable Housing Contributions as well as other 'small site' 'Heads of Terms'.

c) If the applicant opts for the 'Pre-Application Advice,' as part of the pre-application procedure, the council will provide the applicant with a list of potential 'Heads of Terms' and possible contributions for each. The applicant should promptly inform the council whether they are willing to accept these terms. Any necessary negotiations should begin as soon as possible to avoid any delays.

d) Please be aware that the contents of both the 'Template UU' and 'Letter of Agreement' will be kept under review on the council's website.

Appendices

Appendix 1: Financial viability assessment – worked example

i. The following example concerns a scheme proposing 9 homes (gross). For this approach the applicant is required to complete two development appraisals. The first appraisal incorporates the required 20% of affordable housing (with the Plan policy tenure split of 70% low-cost rent and 30% intermediate). The second appraisal assumes that all the homes are provided as private housing. The payment in lieu is effectively the difference between the two residual land values generated by the appraisals. The formula methodology for this approach is set out in ~~supporting text~~ paragraphs 11.1.25 and 11.1.26 of the Plan as follows:

> ***A-B=C***
>
> *Where:*
>
> ***A****= residual value of the proposed development assuming 100% of the residential homes are provided as private housing established though a development appraisal or other method agreed in writing with the council.*
>
> ***B****= the residual value that would otherwise have been achieved by the proposed development incorporating affordable housing in accordance with the affordable housing policy requirement established through a development appraisal or other method agreed in writing with the council.*
>
> ***C****= payment in lieu.*

ii. **Table 3** provides a worked example for illustrative purposes of a scheme proposing 9 homes (gross):

Appraisal input	Scheme incorporating 20% affordable housing	100% private housing scheme
Private sales GDV	£5,040,000	£6,480,000
Affordable housing GDV	£480,000	-
Construction	(£2,287,059)	(£2,287,059)
Contingency	(£114,353)	(£114,353)
CIL/S106	(£98,824)	(£127,059)
Professional fees	(£228,706)	(£228,706)
Sales and marketing	(£144,600)	(£178,200)
Profit	(£910,800)	(£1,134,000)
Finance	(£259,960)	(£381,259)
Gross residual value	**£1,475,699**	**£,1,900,154**

The result is a difference between the two residual land values of £424,455, which is approximately £235,800 per affordable home required by the local plan policy.

A = £1,900,154

B = £1,475,699

C= 235, 800 [424,455 ÷ 1.8 = 235,808]

Appendix 2: Map setting out the affordable housing tariff zones (same as Merton's Community Infrastructure Levy Charging Schedule Map)