CITY OF PLYMOUTH

Subject:	Market Recovery Scheme 2011/2012
Committee:	Cabinet
Date:	29 March 2011
Cabinet Member:	Councillor Fry
CMT Member:	Director for Development & Regeneration
Author:	David Wasserberg, Planning Delivery Officer
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Ref:	
Key Decision:	No
Part:	I

Executive Summary:

1. At its meeting of 15 December 2009, the Cabinet enacted a Market Recovery Scheme (MRS) to support the delivery of development proposals submitted between January 2010 and March 2011. The Cabinet now needs to determine whether to continue with a Market Recovery Scheme for 2011/12. The report sets out the relevant considerations to assist the Cabinet and recommends the continuation of market recovery measures.

2. During times of economic downturn it is important to ensure that the planning system is doing all it can to encourage sustainable development. Plymouth City Council has a history of being proactive in this regard. The proposed MRS sends out the right message to the development industry that Plymouth is very much "open for business" as well as offering practical help to overcome problems of development viability.

3. The MRS helps to create a more encouraging environment for development during challenging economic times. It incentivises development by offering a range of incentives to bring proposals forward. It provides the opportunity for a developer to reduce their planning obligations in return for commencing their development within two years. It also puts in place measures to help developers respond quickly to economic recovery, when it happens, by having "oven ready" consents. These measures enable development to come forward, which otherwise may not have done.

4. Since the Council introduced its first market recovery measures (in 2009) the Planning Service has continued to monitor development viability and a

range of economic drivers that impact on development viability. This has included an assessment of current and/or near term future performance of the economy, the labour market, the commercial property market, house prices, and the mortgage market. These economic and property market analyses suggest that conditions will remain difficult, thereby contributing to the challenging prospects for development viability in both commercial and residential property sectors.

5. It is therefore recommended that a Market Recovery Scheme be enacted for the next fiscal year. It is proposed that this new MRS enhance the incentives provided in the 2010/11 MRS, as outlined in the report, so as to give greater encouragement to economic development and job creation.

Corporate Plan 2011 – 2014

The Market Recovery Scheme is specifically designed to enable continued delivery of the Growth priority during this period of economic uncertainty. It helps to bring development forward by improving viability.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

The continuation and extension of market recovery measures has the potential to reduce income secured through the Plymouth Development Tariff. However, given that the MRS itself seeks to make development viable which would otherwise be unviable, the MRS is actually likely to deliver more tariff income than would otherwise be achieved without the incentives. This is because an unviable development will simply not be delivered, and therefore no income will be received. In addition, the impact of not continuing the scheme may be to delay or even prevent employment generating and other development to the detriment of economic recovery. If development is delayed or prevented then those tariff contributions could be lost for good. Clawback provisions enable some of the reduction to be recouped should the development take place when economic conditions have improved.

Other Implications: e.g. Section 17 Community Safety, Health and Safety, Risk Management, Equalities Impact Assessment, etc.

The MRS is an integral part of the Planning Obligations and Affordable Housing SPD which forms part of the LDF. The LDF was subject to Equality Appraisal.

The MRS helps to manage risk associated with the SPD, specifically:

- The impact on land values, with potential reduction in development sites coming forward in current economic downturn.

- The impact on development viability, given the extent of developer contributions sought.

Recommendations & Reasons for recommended action:

That Cabinet approve:

1. The 2011/2012 Market Recovery Scheme for planning applications submitted by 31 March 2012, as set out in the Appendix.

   Reason: To respond to the continuing adverse market conditions and enable Plymouth's economy to move forward quickly as the economic recovery starts.

Alternative options considered and reasons for recommended action:

Not extending the MRS for a further year could delay or prevent development from occurring in these challenging economic times.

Background paper:

Market Recovery Scheme 2010/11

Sign off: comment must be sought from those whose area of responsibility may be affected by the decision, as follows (insert initials of Finance and Legal reps, and of HR, Corporate Property, IT and Strat. Proc. as appropriate):

Fin	DevF 1011 0063	Leg	JAR/1 1133	HR	n/a	Corp Prop	n/a	IT	n/a	Strat Proc	n/a
Originating SMT Member need to complete this section											

1. BACKGROUND

1.1. The MRS responds to the difficult economic environment that has made some development less viable. It incentivises development by offering developers the opportunity of reducing their planning obligations in return for commencing their development within two years, and puts in place measures to help developers respond quickly to economic recovery, when it happens, by having "oven ready" consents. These measures enable development to come forward, which otherwise may not have done. The price, however, is a reduced contribution to infrastructure and other related works. However, most planning obligations now have clawback arrangements whereby, should the development take place once the economy has improved, some of the reduced contribution can be recovered.

1.2. The genesis of the MRS was that in October 2008 the Cabinet approved the first Market Recovery Action Plan (MRAP) to incentivise development in the city. This was supplemented by a 10-point action plan introduced within Planning Services. Amongst other things, this invited developers to bring forward development proposals early in exchange for a range of incentives. Ten planning permissions were secured through this initiative. One of the developments has been completed, and a further three are under construction. The total construction value of the ten approved schemes is £134million. This is development that, were it not for the MRAP, may never have come forward.

1.3. The process of renewing both the existing Planning Obligations and Affordable Housing Supplementary Planning Document and MRAP began in October 2009. The Council commissioned a Viability Report by GVA Grimley to assess the impact of the Council's planning obligations on development viability. The report provided evidence which justified the continuation of the discounts available under MRAP and also suggested that the benefits could be more easily accessed. MRAP was rebranded as the Market Recovery Scheme. The 2010/2011 MRS was enacted by Cabinet on 15 December 2009, pursuant to para. 1.8 of the Supplementary Planning Document and revised to accommodate flexibilities introduced by the adoption of the First Review of the SPD on the 2 August 2010.

1.4. The GVA Grimley Viability Report included development appraisals for ten development typologies in Plymouth. Only two of the ten were viable when the development proposal had to meet the Council's full planning obligations. These were "big box" food retailing (such as the Tesco at Transit Way) and high-end, waterfront residential developments.

1.5. Since the Council approved the MRS, the Planning Service has monitored development viability in Plymouth to see whether the discounts continue to be justified. In the first half of 2010 there were encouraging signs that the economy and local housing market were recovering. However, in the latter half of 2010 the recovery stalled and house prices once again retreated. Currently, the housing market is moving "sideways" without a clear indication as to whether it will regain its recovery trajectory or decline further in the short term.

2. THE CASE FOR CONTINUING THE MARKET RECOVERY MEASURES

2.1. This section of the report evaluates economic drivers that impact development viability. It makes the case for extending MRS for another fiscal year. It includes an assessment of the economy, the labour market, the commercial property market, house prices, and the mortgage market.

Economy

2.2. During the economic contraction of 2008-9, Plymouth's economic growth declined at a rate slightly greater than the South West and the national level. In addition, South West Observatory expects Plymouth's economy to recover more slowly than the region or nation. Over the next five years, Plymouth's economic growth is expected to be about 0.8% per annum. As the table below illustrates, this low rate of growth is about a third of the rate for the south west region and the nation.

	1995-2005	2008-09	2009-10	2010-11*	2010-15*
Plymouth	1.0%	-6.7%	0.4%	0.4%	0.8%
South West	3.2%	-5.9%	1.9%	2.2%	2.5%
UK	3.0%	-6.2%	1.6%	2.0%	2.3%

* forecast

Source: South West Observatory

Employment

2.3. According to the Office of National Statistics (ONS), the unemployment rate in Plymouth in the 3Q 2010 (the most recent available data) was about 8%. This is was equivalent to the national level. Forecasts show that the national unemployment rate is expected to remain at about its current level during most of 2011/12. With employment growth expected to be weak on the national level; Plymouth's high dependence on public sector employment (see paragraph 2.5 & 2.6); and the low private sector presence (see paragraph 2.7), it is likely that employment growth in Plymouth will be weak.

2.4. Different from the ONS data, the South West Observatory's economic model shows a Plymouth unemployment rate of about 4.0%. The Observatory's central forecast shows that Plymouth's labour market will moderately deteriorate in 2011/12. The unemployment rate is expected to increase from the current rate of 4.0% to 4.2% at the end of 2012. At the same time, the number of unemployed is expected to increase from 6,700 to 7,100.

2.5. One of the factors contributing to Plymouth's weak labour market outlook is its dependence on the public sector. In 2008, 28.8% of jobs in Plymouth were in the public sector (compared to 19.5% nationally). Given the budgetary pressures at both the national and local government level, it is likely that there will be limited new public sector jobs being created in 2011/12. This will restrain Plymouth's economic recovery.

2.6. The annual Centre for Cities' "Cities Outlook 2011" highlights the labour market challenge for Plymouth. Among all the major cities in England public sector cuts (as a % of overall employment) could be the highest in Plymouth. The report shows how public sector cuts in Plymouth could reduce the local job base by between 2.3% and 3.1%.

2.7. The Cities Outlook 2011 report also points to Plymouth's relatively small private sector. Only two other cities in England have fewer businesses per 10,000 population. They are Middlesborough and Sunderland. While Plymouth has about 200 businesses per 10,000 population, the average in the UK is about 350. The small size of the private sector will restrain Plymouth's ability to increase private sector payrolls in the near-term.

Commercial Property Markets

2.8. Given the challenging national and local economic context, prospects for commercial property development are not favourable. Knight Frank's forecast puts the situation starkly: "We predict no real increase in development activity through 2011, owing to limited availability of debt finance and the impact on viability of the high cost of the funding that is available coupled with increasing construction costs. Weak occupier demand means that the only development likely to take place will be good quality pre-let schemes or those projects that can be started with equity finance or from declining levels of public sector support."

2.9. Given the near-term economic forecast, it is likely that the demand for commercial property will remain subdued. In King Sturge's forecast for the office sector in 2011, it states that **"Demand is most under threat in second-tier cities. This is where the highest concentrations of public sector activity lie. It is here where we expect office take-up to be hit hardest."**

2.10. At King Sturge's annual south west property review event this February, local agents said that for the first six months of 2011 they expected demand for commercial space to remain soft. However, they said that there was a possibility the market would improve in the latter half of the year.

2.11. King Sturge's and Cushman & Wakefield's property market data shows that Plymouth's three commercial property sectors are currently facing challenging conditions. The **office market** has a vacancy rate of 10%. Cushman & Wakefield puts office rents at their lowest level since 2003. Plymouth's **industrial market** has 1.2 million sf in available space. Due to this glut, Plymouth has the lowest rents among the major south west regional centres. The local **retail market** is also struggling. While its vacancy rate of 10% is lower than competing centres such as Bristol and Swindon, data from

Cushman & Wakefield shows that Zone A rents are the lowest they've been since 1988.

2.12. Based on these assessments of Plymouth's commercial property markets, there is little justification for changing the 100% discounts currently available. **In fact, given the difficult labour market conditions, it is recommended that the discounts currently available for B1/B2 commercial uses be extended to all commercial proposals that lead directly to the creation of new, non-retail employment.**

House prices

2.13. According to the Land Registry, house prices in Plymouth and England/Wales both peaked in October 2007. They then fell steeply, reaching their lowest level in April 2009. However, house prices in Plymouth fell further than the national market (-19.1% versus -16.7%).

2.14. In October 2009 when the GVA Viability Report was commissioned, house prices in Plymouth were beginning to recover. At the time of the report, house prices were 15.3% below their peak. During the first half of 2010, the housing market continued to recover, achieving its highest post-recession level in May 2010. Since May 2010, house prices began to fall again so that by the end of 2010 they were 13.5% below their peak. Given Plymouth's uncertain economic outlook, it is unlikely that Plymouth house prices will stage a significant recovery in 2011.

	Plymouth	Price decline (since peak)	England / Wales	Price decline (since peak)
October 2007 (peak)	£148,088	-	£182,939	-
April 2009 (trough)	£119,866	-19.1%	£152,440	-16.7%
October 2009 (last viability exercise)	£125,396	-15.3%	£160,091	-12.5%
May 2010 (post-recession peak)	£133,160	-10.1%	£165,706	-9.4%
December 2010 (most recent data)	£128,085	-13.5%	£163,814	-10.5%

Source: Land Registry

House price forecasts

2.15. King Sturge forecasts house prices in the City Centre will fall 3% in 2011.

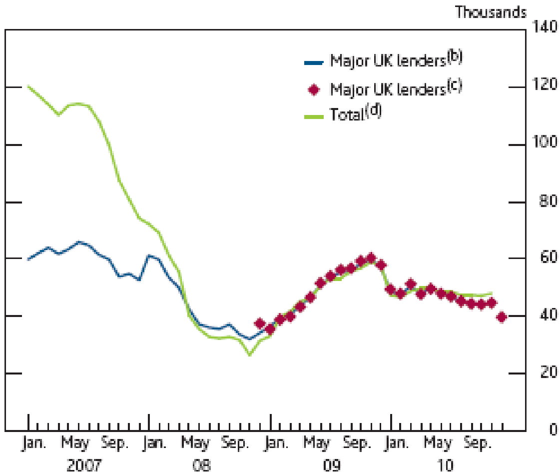
2.16. Savills, another property agent active nationally and in the region, writing about the national housing market, states that "house prices in prime regions will soften over the course of 2011 due to weakened buyer sentiment, increasing stock levels, the rising cost of living and accessibility to mortgage finance remaining tight". Savills forecasts a 1.5% decline in prime regional markets and that mainstream UK markets are likely to see falls of 3%.

2.17. While Knight Frank has yet to produce their annual forecast, their sentiment is consistent with other agents. They write in January that "the three main issues for the market in 2011 are falling household incomes, mortgage market restrictions and the risk of rising interest rates." They go on to say that "We are unlikely to see strong capital growth in any residential sector in 2011."

Mortgage market for housing

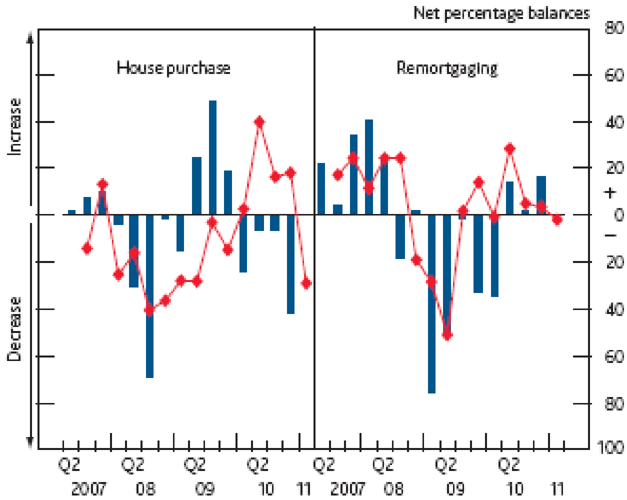
2.18. Compounding the forecast of a slow recovery in house prices, the Bank of England reports that at the end of 2010 monthly mortgage lending levels remained only moderately above 2008's recessionary levels and below the post-recessionary peaks at the end of 2009. (See chart below.) Given the guarded outlook for Plymouth's economy and labour market, it is likely that mortgage approvals in Plymouth will remain subdued in 2011.

Chart 1.7 Approvals for mortgages for house purchase



2.19. While the Bank of England reports that mortgage availability in the UK has modestly improved since the constrained market of 2007 to 2009, the demand for mortgages declined steadily during 2010. This is likely to reflect pessimistic prospects in the household sector. (See the left-side of the chart below.)

Chart 3.4 *Credit Conditions Survey*: demand for household secured lending[(a)(b)]



3. CONCLUSIONS

3.1. The current economic climate continues to be challenging. Economic and property market forecasts suggest that conditions will remain difficult in the near-term, thereby contributing to the poor prospects for development viability in both commercial and residential property sectors. It is important that the planning system is not seen as a deterrent to the creation of jobs. A market recovery scheme for 2011/2012 is therefore recommended. It is also recommended that <u>any</u> application which generates new, non-retail employment should be able to access the benefits of the MRS. This would extend the current benefits to hotels (C1) and leisure uses (D2). A further recommendation is that for projects that can be delivered early, the management fee is waived.

Appendix: Proposed Market Recovery Scheme, 2011/12

The following market recovery measures are applicable for planning applications validly submitted between April 1 2011 and 31 March 2012.

INCENTIVE TYPE 1: Measures to encourage early delivery of projects during times of economic downturn:

- Up to 100 % discount on tariff for development of employment uses within the B Use Classes as well as those that generate significant levels of new employment such as hotels and leisure uses (C1 and D1).
- Up to 50 % discount on tariff for other development on brownfield sites.
- Up to 25 % discount on tariff for other development on greenfield sites.
- Up to 50 % reduction of the full affordable housing requirement may be considered, together with the possible use of gap funding to support affordable housing delivery.
- 100% discount on the planning obligations management fee.

The higher potential discount for employment uses is justified on the grounds of economic viability and the urgent need to support employment growth given the continuing fragility of the local and national economy.

The following conditions must be met to benefit from these discounts / flexibilities:

1. The case for these discounts shall be proven, unless otherwise specified below, through an open book viability appraisal which establishes that under current conditions the development may not achieve an acceptable level of viability.

2. Developers must agree to a two-year consent, and to make a substantial start on the approved development within two years of the grant of consent

3. In appropriate cases, consideration will be given to making the consent personal to the applicant.

4. For strategically significant development proposals, where the affordable housing provision is critical to the achievement of the Core Strategy's Affordable Housing target, the Council reserves the right not to agree to a relaxation of the affordable housing requirement.

5. Flexible phasing of payments of the discounted tariff may be considered where this is justified by the financial appraisal, subject to 'clawback' provisions being incorporated as part of the planning agreement.

The circumstances where a viability appraisal is not required are:

- An application for a C3 use of less than 15 units
- An application for a C4 use of less than 15 bedspaces

- An application for a Sui Generis HMO development of less than 15 bedspaces

INCENTIVE TYPE 2: Measures to help developers respond quickly to economic recovery by having 'oven-ready' consents:

- Extended planning permission periods to be considered (up to 7 years)
- Flexible phasing of payments of planning obligation requirements.

The following conditions must be met to benefit from these flexibilities:

1. The case for the time extension is to be established through an open book viability appraisal which shows that the development may be unviable under current conditions and that extended permission which includes an assumed improvement in the economy will enhance viability.

2. If actual level of payment is to be determined by end value of development, a 'clawback' mechanism will be needed.

Exemptions from the requirement to pay tariff in certain cases:

No tariff to be charged for developments of less than 5 homes. This is justified on the grounds of encouraging a continuing supply of smaller sites to be brought forward during the ongoing difficult conditions for the residential development sector

(NB: The SPD already provides that commercial developments of less that 500 sq.m. are also exempt from paying tariff).

This is a continuation of measures that were in place during the calendar year of 2009.

In addition to these specific measures, flexible and innovative approaches to service-delivery will be adopted, including:

- Positive approach to deeds of variation to assist with re-phasing of s106 contributions where this is justified by open-book viability appraisal

- Improved and quicker pre-application process with opportunity for Council to work with developer on Site Planning Statements to provide clear framework for the planning application

- An openness to partnership working to help bring forward planning applications for strategic projects identified through the Local Development Framework

- Requests for consideration under the Market Recovery Scheme should be made when pre-application discussions are initiated with the Planning Service