Andrew Golland Associates

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VIABILITY BULLETIN

By Dr Andrew Golland
BSc (Hons) PhD MRICS

Viability and dealing with costs – a discussion paper

The market

Of all the variables that are projected, discussed and argued about in viability appraisals, costs are usually the most difficult to deal with. And of late, there is much exasperation over them because development in the UK faces a largely static housing market against a backdrop of rising costs.

This means a danger of land values actually falling as a development progresses. This has to be reflected in 'on costs' or other development items such as finance and/or margin. Lenders won't provide backing without margins being at the highest levels and lending rates towards the top end of the scale.

These are evidently practical and financial issues for the house building industry. However, the situation facing local authorities is also very challenging.

The local authority position

Local planning authorities are tasked with meeting policy objectives. Faced with a situation where a developer or other applicant presents a non-viable case, then interrogating costs is clearly a sound starting point.

Typically, and traditionally, viability assessments have relied on industry standard sources and data bases such as the RICS's BCIS (Building Cost Information Service). This source is cited within the NPPG (National Planning Policy Guidance) as, effectively, a first port of call when taking decisions on planning application where viability is an issue.

The advantage of using such an industry standard, from the local authority's viewpoint, is that the Council can turn around to an applicant with 'high' build costs, and say 'if the industry can build for £x per square metre, why can't you?'.

The simple and very obvious rebuttal to this question is 'well my/our scheme isn't industry standard'.

There might be several reasons why a particular scheme is not standard including a higher specification, a particularly 'difficult' design or build and/or the fact that the scheme cannot be benchmarked against industry standard sources because those sources don't provide cost categories that are fine grain enough to deal with the particular scheme details.

Local authorities will then, in some circumstances accept or invite a detailed quantity surveyor report on indicative costs for the scheme. How keenly this route is used depends on the authority. Some won't entertain such a route and will refer a developer back to the cost assumptions in the local plan, whilst other positively promote QS reports in SPG/Ds for example).

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There are up, and downsides to both parties here. Where a LPA won't entertain a QS report, they run the risk at appeal that a more detail report 'trumps' general figures adopted in the Plan or sourced from an industry standard database. Where a QS report is agreed, then invariably the LPA will want it reviewing by another QS from their side or jointly appointed. This means not only having the main viability report reviewed, but also the QS report. With large schemes these additional costs (invariably borne by the applicant) are often 'washed through'. However with smaller and medium schemes these checks are costly and can have significant time implications.

There are no easy answers here, although the best way to get agreement between all parties is undoubtedly via benchmarking. If it can be explained why and how a scheme differs from a standard, that gives the LPA confidence to take an informed decision where a reduction in the levels of Section 106 is being sought on viability grounds.

Benchmarking

Whilst benchmarking is helpful, it remains imperfect. The key cost data sources provide general statistical information in terms of 'mean, mode or quartile costs'. But applying this information to a particular scheme is usually challenging. What data, which firms underlie the data sources, and how might they differ from the applicant firm or contractor?

More systematic data gathering by both the private and public sector here would help solve the challenge of more robust benchmarking.

Construction costs beyond the plot

The assessment of costs beyond the 'plot' (foundation, sub and superstructure and services) are typically more difficult; and it's here where viability reports often are unclear. Four typical costs are identified:

- External works (gardens, borders, walls etc);
- Infrastructure (typically green field for unserviced sites);
- Ground works – raising and cutting levels;
- Abnormals – site decontamination, demolition etc

In some appraisals all four types of cost are lumped together as 'abnormals', in others they appear as sub-sets of the above. There is little standardisation.

Externals have traditionally been taken at 15% of plot costs, although with more complex sites this figure probably needs to be closer to 20%.

Green field major servicing costs can range from (figures I have encountered) anything from £10,000 per plot to £50,000 a plot.

Abnormals are bespoke to a site although the HCA, some while ago now, provided indicative decontamination costs for different types of existing use to a range of end uses on a per hectare basis. Again, a bespoke report may be agreed between the parties.

Factoring in future costs

Standard practice suggests that viability assessment should take place in the 'here and now'. This is particularly emphasised where the assessment of GDV is being considered.

On the cost side, applicants are keen to reflect likely changes in legislation and standards that will impact on their schemes during the course of the build out.

The latest UK building regulations (England) emphasize enhanced safety, energy efficiency, and sustainability, with significant updates in 2022 and October 2023. Key changes include stricter carbon emission standards (Part L), new requirements for overheating mitigation (Part O) and electric vehicle charging (Part S). Whilst these costs should now be being picked up through the industry standard data sources, this is often disputed by applicants as to whether this is actually happening. There is often a charge that the sources are not up to date.

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New homes should be built from next year, to 'Future Homes Standard' to produce at least 75% less carbon than current standards – heat pumps, high performance insulation and solar panels are features of the programme. The current estimate of the cost of Future Homes is circa £5,000 per dwelling, a significant cost to schemes.

The difficulty for viability assessment is that the industry pushes for these projected costs to be included often prior to their incidence, but is at the same time reluctant to factor in potential increases on the revenue side via changes in house prices and/or improved offers for Affordable Housing elements. Local authorities will point out that contingency (an industry standard inclusion normally at around 5%) in most appraisals, is there to take care of such eventualities. Where an impasse is reached, a viability review mechanism is probably the only way ahead. Applicants are reluctant to use these where the market is difficult so this area is altogether tricky.

Towards better practice in dealing with costs

It is important to recognise that construction costs are very challenging to deal with. It's easier to get agreement on margins, fees and finance, not just because these constitute smaller numbers, but because there is software available (notably the GLA Toolkit) which has benchmarks or default figures.

With construction costs, the industry 'gold standard' BCIS is incredibly helpful to viability assessment but the 'bridge' to bespoke scheme assessment needs improvement.

This relies on both the industry being more transparent on its costs – and in particular demonstrating how specification and market sector impacts on costs – as well as local authorities gathering cost data in a systematic way so as to be able to respond more robustly on whether a QS estimate will be required or be acceptable.

The difficult area in making these steps is confidentiality but there is nothing stopping sectors within the market putting together data and anonymising it to the benefit of the process.

Better information, clearer processes with respect to cost assessment and improved benchmarking all lead to a smoother viability analysis.

I would welcome feedback on how this, and related issues, might streamline the viability assessment process.

Andrew Golland Associates specialises in the field of housing, planning and regeneration

For more information, please contact:

Dr Andrew Golland BSc (Hons) PhD MRICS
Tel: 0116 270 1772 or 07821 965748
drajg@btopenworld.com
www.andrewgollandassociates.co.uk

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