Build Now, Pay Later

Introduction

The Government is committed to bringing forward public land with capacity to deliver up to 100,000 homes over the Spending Review period, and support as many as 200,000 construction and related jobs during development. Tackling the sustained shortfall in housing development is a Government priority and a key objective of the Growth Review. The amount of previously-developed land owned by the public sector is more than twice the size of Leicester.

The Prime Minister previously announced his intention to extend the use of Build Now, Pay Later to as much surplus public land as possible, where there is market demand, it presents good value for money and is affordable. This commitment is also set out in the Government's Housing Strategy for England[1]. The aim is to stimulate development activity and incentivise developers to commence development early by deferring payment to match the developer's cash flow.

The Benefits of Using Build Now, Pay Later

Advantages to developers

In the current economic and financial climate some developers are unable to commit their limited capital resources to upfront full payments of land value and this continues to be reflected in developers' responses to some major public land redevelopment opportunities.

The rationale for using Build Now, Pay Later is that it allows the developer to better manage development cash flow as land is not an upfront payment and, depending on the approach, can also allow some sharing of the risk on sales values between landowner and developer.

[1] *Laying the Foundations: A Housing Strategy for England* (HM Government, November 2011)

Advantages to landowners

Government rules for disposing of surplus land (Managing Public Money) state that land should be sold as swiftly as the market will allow and within three years. Government departments and their agencies should consider using Build Now, Pay Later where there is a strong likelihood that it will enable a site to be disposed of early, and leads to the accelerated delivery of homes.
Value for money is essential and the use of Build Now, Pay Later must clearly demonstrate that value for money is achieved if sites are disposed of on this basis with the benefits of Build Now, Pay Later tested against other payment options on a case by case basis.

When is Build Now, Pay Later a suitable approach?

Build Now, Pay Later is not appropriate for all sites and will tend to be more beneficial on larger more complicated sites which will require significant capital investment to unlock. These sites may require significant infrastructure, expensive remediation or other major development costs. There may also be planning uncertainty, and where development revenues are likely to be spread over several future years.

Build Now, Pay Later may also be appropriate where a site has high land values or conversely where changing payment terms improves the viability of marginal schemes. For sites located in stronger markets with the potential for house price growth over the development cycle, Build Now, Pay Later may also secure greater returns for the landowner.

Build Now, Pay Later is one of a range of mechanisms available to public landowners and in some circumstances, joint venturing may be more appropriate.

Build Now, Pay Later Terms

The use of Build Now, Pay Later should be tested on a site by site basis to ensure value for money and affordability. The most comprehensive way to evidence this is to compare bids on Build Now, Pay Later terms against the traditional upfront payment with overage.

Because Build Now, Pay Later reduces the developer's finance costs (and allows their limited development capital to go further) and provides some degree of risk sharing, it should be more attractive to the developer than an upfront single payment. This should be reflected in the developer's financial offer for the land and may enable the site to be disposed of earlier. The different Build Now, Pay Later models include:

Phased Payments

The Phased Payments approach is commonly used across the public sector and is where the land value or base price is apportioned across a number of phases with specified dates or triggers for when payments will be made.

As the full land value is not paid upfront there is less pressure on the developer's cash flow and financing facility. The developer bears less initial risk as payments are linked to completed or sold phases and again should be reflected in the price bid and the willingness of developers to compete for the site. The timing of payments and percentage of land value paid on completion of each phase can be varied to suit the risk characteristics of the site, i.e. greater receipts later in the development cycle may improve the development cash flow further.

Risk sharing

Risk sharing based on a percentage of receipts in many instances may enable larger sites requiring significant infrastructure investment to come forward more quickly and may be attractive to developers in markets where there is greater uncertainty over receipts. The approach will not normally specify payment dates or the amount to be paid on completion of each phase but will apportion the sales receipts between the developer and landowner. The percentage share will typically be the outcome of the competitive process. The model can include longstop payments.

The model relates to sharing risk and reward from market movement in house prices and the subsequent revenue generated but do not include sharing the risk of fluctuations in development costs which would be borne by the developer.

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