

*Urban Scale*  
**The Evidence base for investment in urban  
regeneration**

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# The evidence base for urban regeneration

## Urban Scale

### Evidence-based Design in the Built Environment

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# Brindley Place & King's Cross



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# Context

- **Mixed-use regeneration perceived as risky**
- **Regeneration - government priority in attracting private finance**
- **Scale of institutional capital has been limited**
- **Major regeneration schemes such as Thames Gateway will require £20 billion enhanced participation by institutional investors**
- **Morley Property Fund total assets £21 billion**

# Urban Task Force Report 1999/2005

- Better use of derelict, vacant and under-used land in order to enable target of 60% of new housing development on brownfields
- Champion design-led regeneration and high quality public space in making urban neighbourhoods attractive places to live
- Encourage private sector investment in regeneration - national public-private investment funds
- Significant progress in culture in favour of towns and cities reflecting a nationwide commitment to Urban Renaissance
- 2005, 70% new development on brownfields compared to 1997, 56%
- Sustainable regeneration of large complex areas eg Thames Gateway suffers from fragmented decision making processes and institutions which lack coherent area based delivery mechanisms

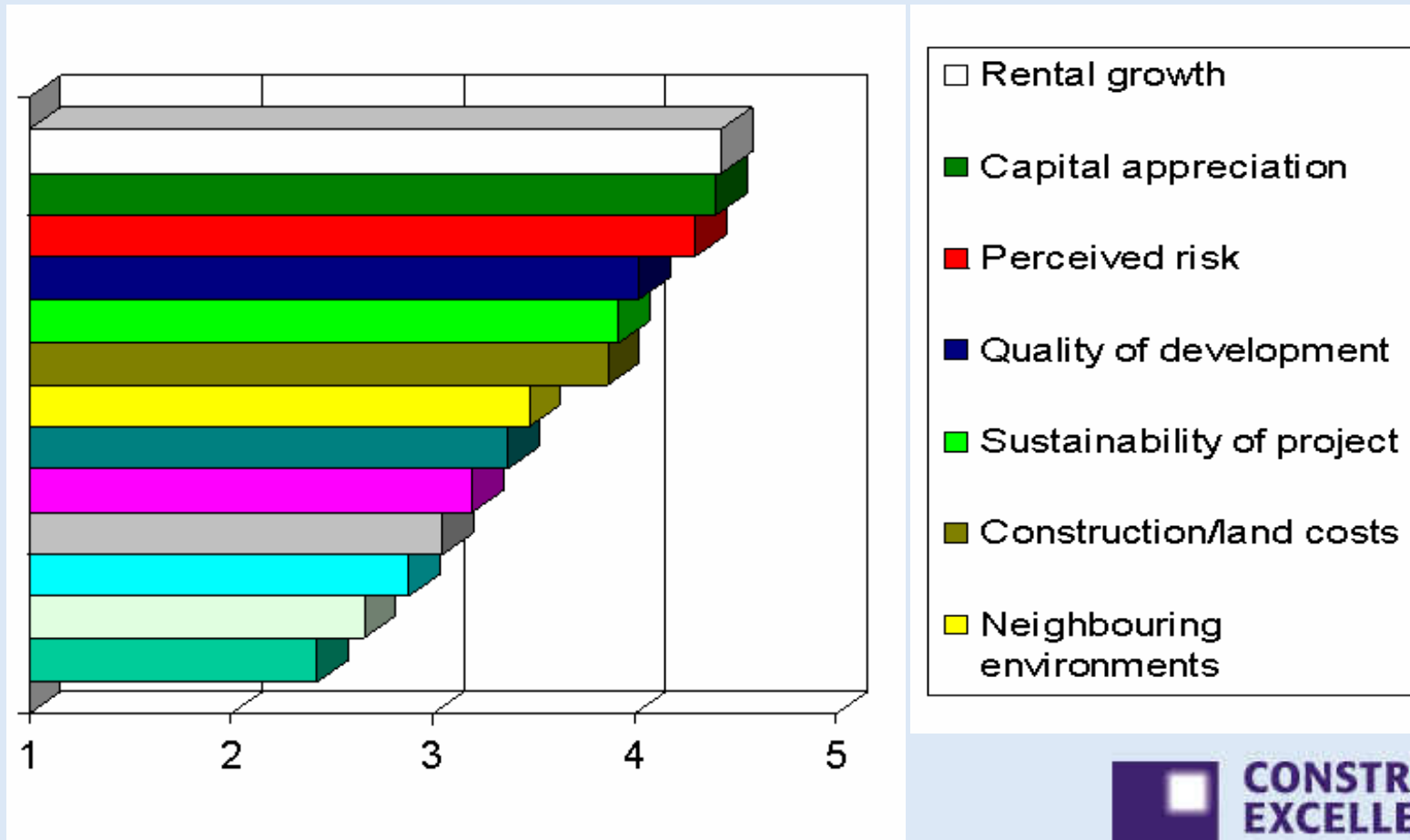


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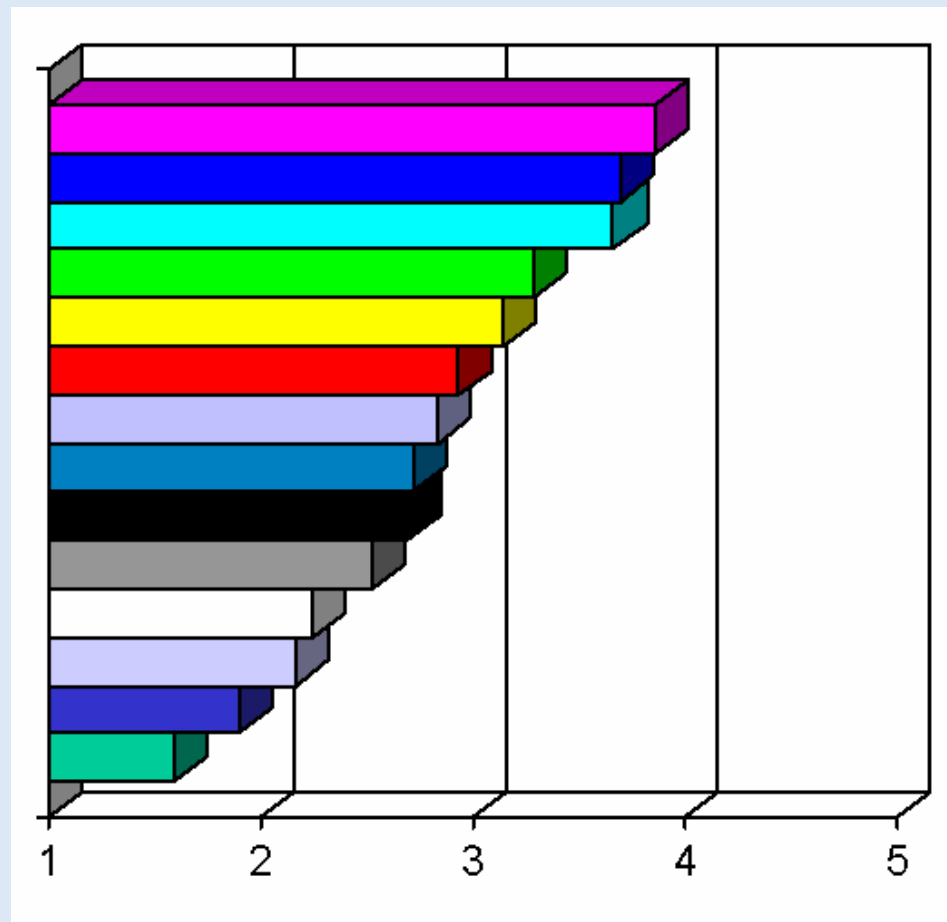
# Methodology – 3 strands

- **Strand 1. Comparison of the findings of the Joseph Rowntree study into barriers to private sector investment in regeneration and structured interviews with institutional investors regarding their perceptions of regeneration investment opportunities**
- **Strand 2. Analysis of regeneration performance based on the Urban Regeneration Index (IPD et al, 2006)**
- **Strand 3. A cross-asset class examination involving key institutional investors to determine the components of a model to encourage institutional investment into regeneration**
- **Over forty chief investment officers, investment managers**

# Criteria for evaluating investment in urban regeneration projects

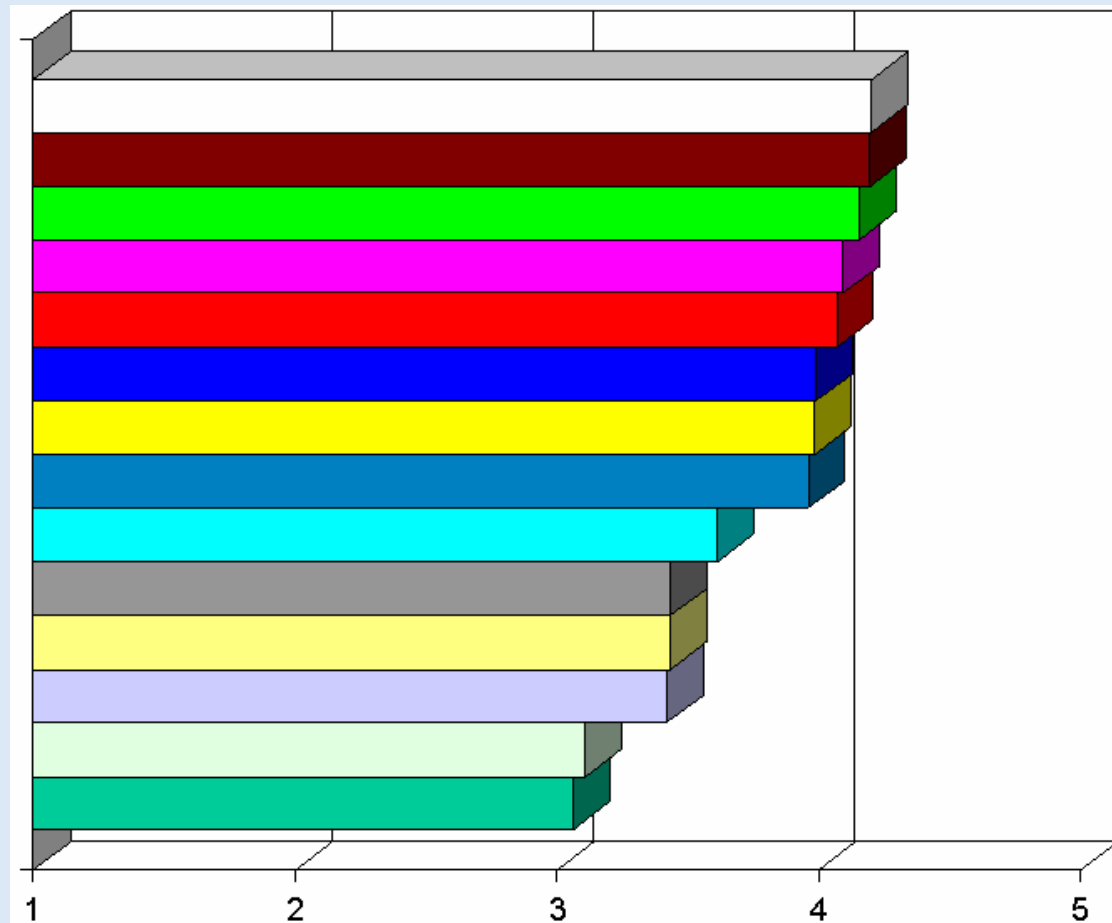


# Perceptions of urban regeneration : non-investors



- Low rates of capital appreciation
- Low rental growth
- Quality of neighbouring environments
- Grant regimes are insufficient
- Bureaucratic grant regimes
- Inflated construction and land costs
- Inadequate taxation breaks
- Site assembly insufficient
- Added management

# Factors perceived necessary to improve the flow of private sector finance : investor survey

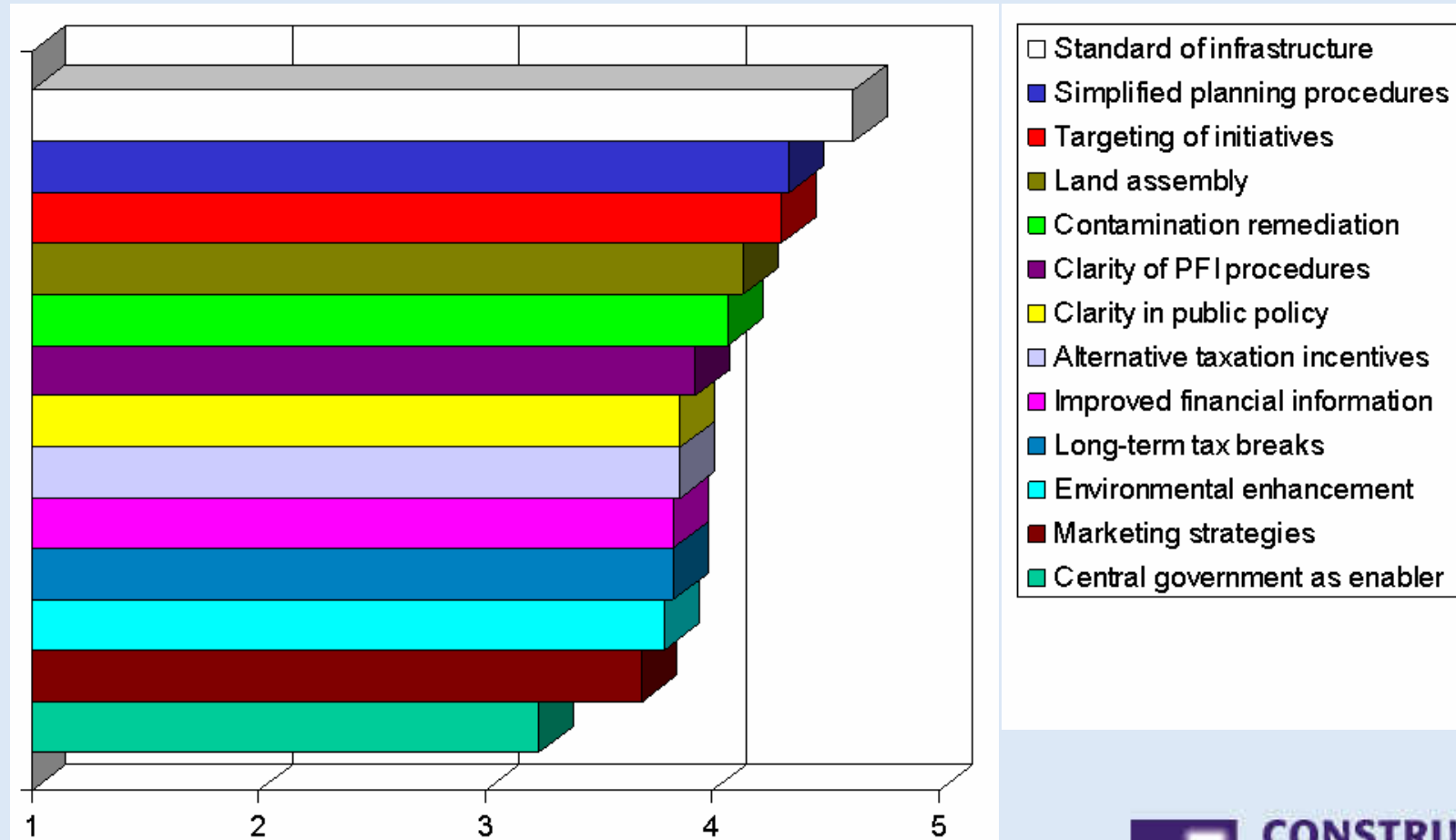


- Contamination remediation
- Simplified funding procedures
- Clarity in PFI procedures
- Land assembly
- Clarity in public policy
- Targeting of initiatives
- Simplified planning procedures
- Standard of infrastructure
- Environmental enhancement
- Central government as enabler
- Improved financial information
- Marketing strategies
- Long-term tax breaks
- Increased accountability

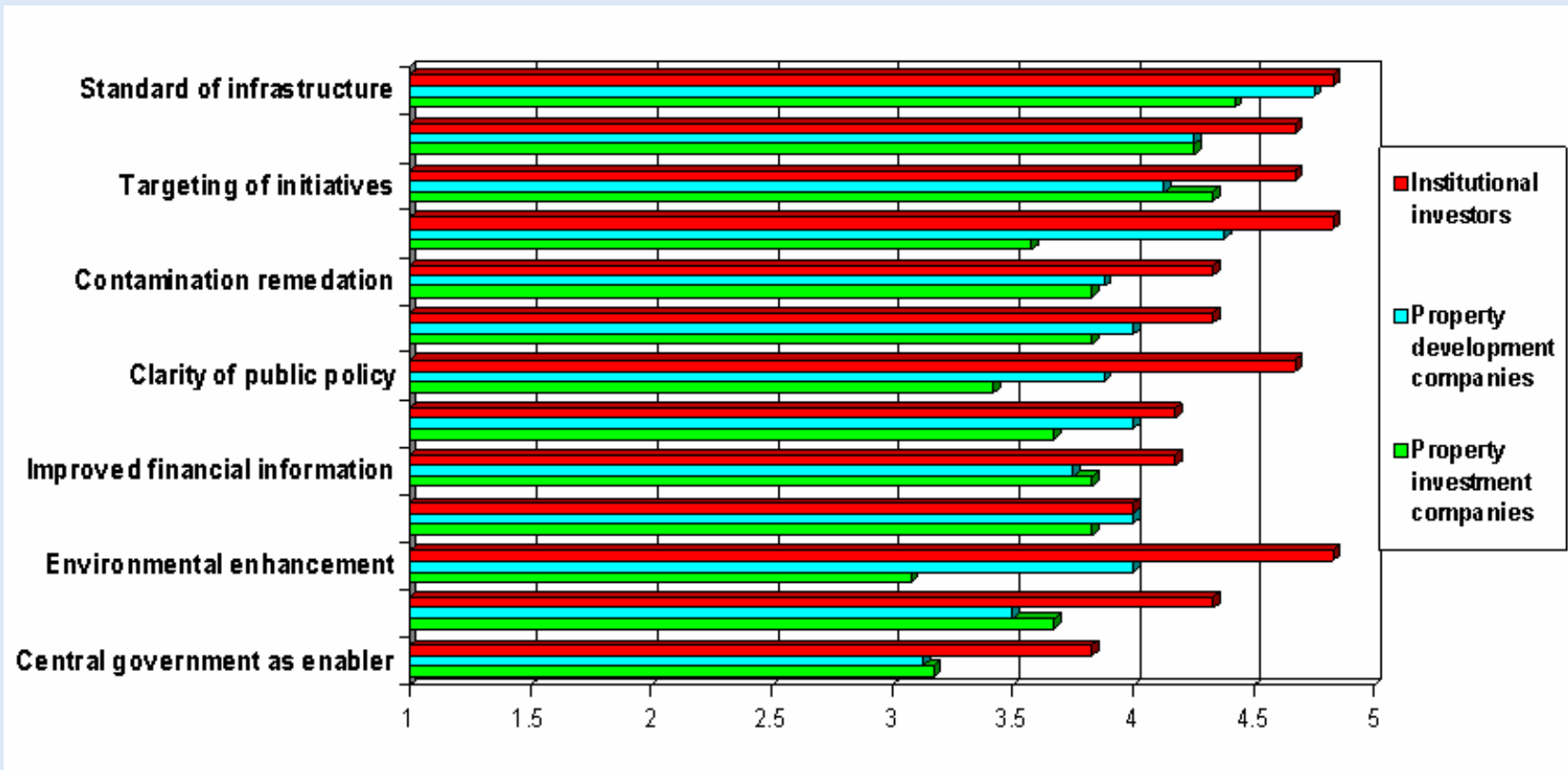


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# Factors perceived necessary to improve the flow of private sector finance : non-investor Survey



# Factors perceived necessary to improve the flow of private sector finance : non-investors



# Key messages

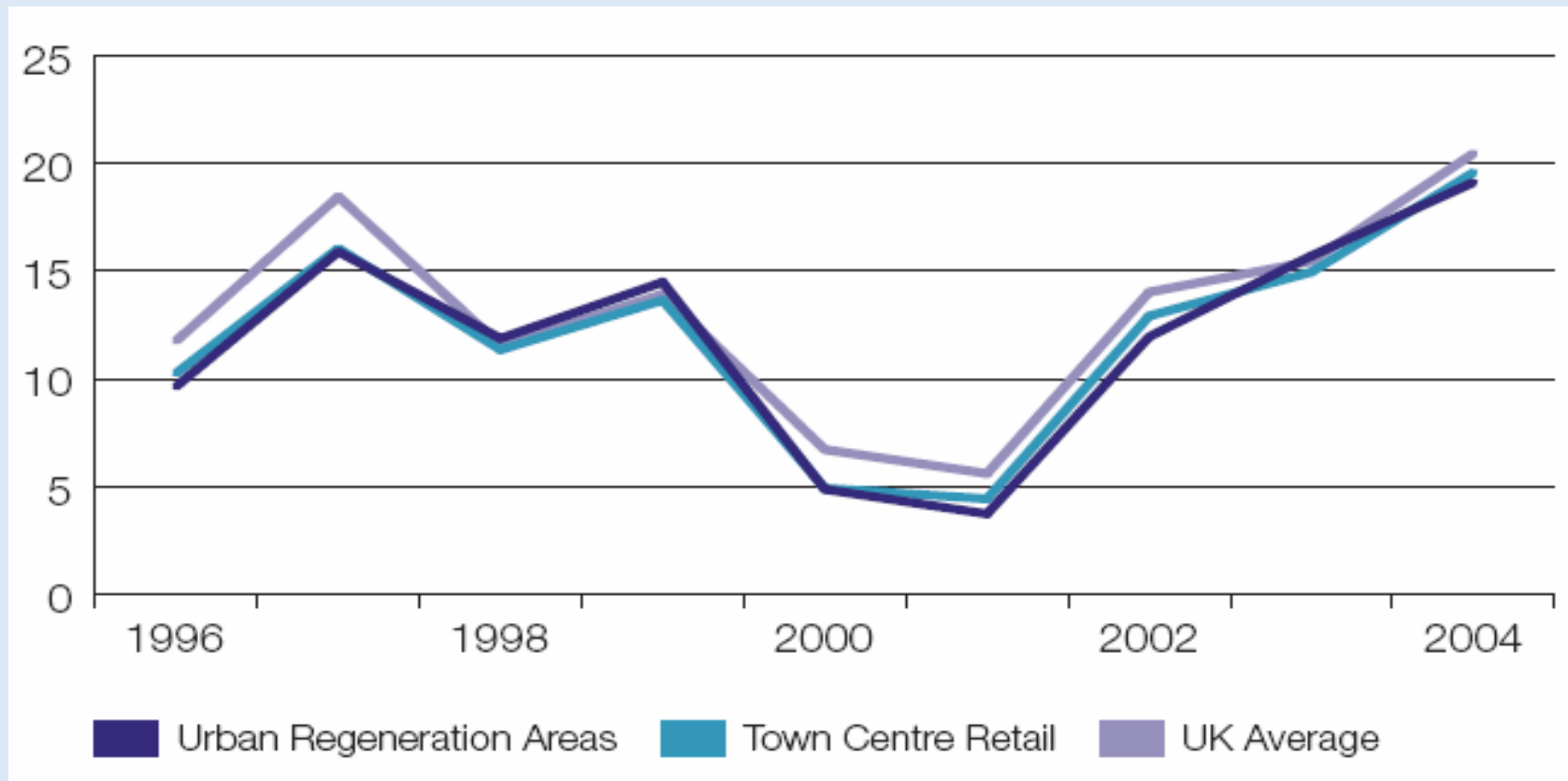
Key messages arising from the Rowntree study:

- perceived total return is primary factor influencing investment
- companies which retain their investments in regeneration locations do so in the expectation of achieving above average returns
- perception of investment security and the spreading of risk are significant factors, though investors attach greatest significance to return as being the primary motive for holding a regeneration portfolio
- principal barriers to investment in regeneration were perceptions of negative returns
- need for simplification of the planning process
- need for clarity and certainty in regeneration policies

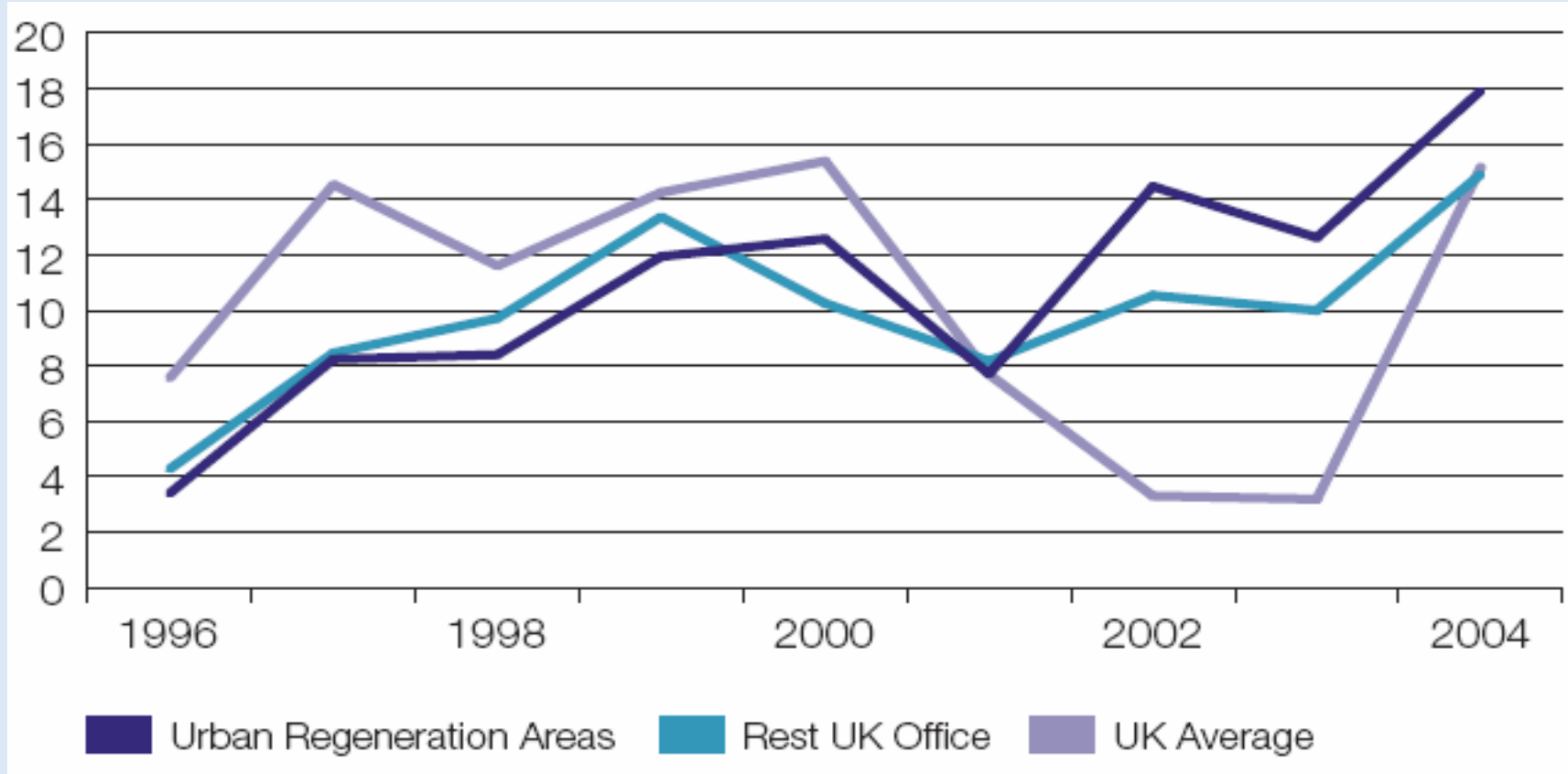
## Methodology – Strand 2

- Analysis of regeneration performance based on the Urban Regeneration Index (IPD *et al*, 2006)
- Covers locations where there is a current urban regeneration programme supported by the public sector
- 741 properties with a capital value of £4.4 billion compared with the IPD universe of 10, 986 properties / £120.8 billion.
- Sectoral composition, on the basis of capital value, is 67.3% retail, 9.3% offices and 21.2% industrial

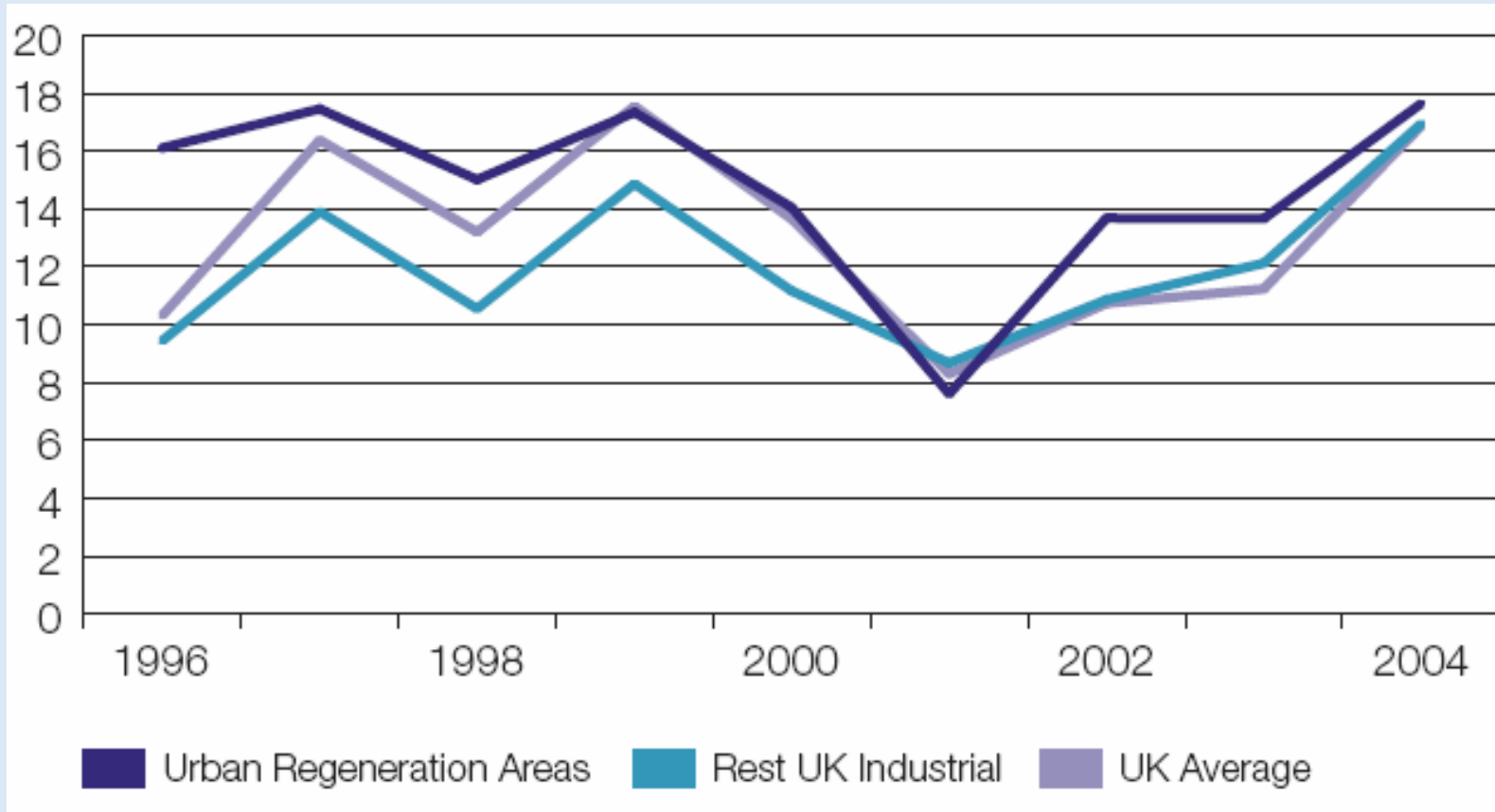
# Retail Total Returns – per cent return



# Office Total Returns – per cent return



# Industrial Total Returns – per cent return



# IPD Regeneration Index 2005

- Commercial property in urban regeneration areas has delivered significant returns over the longer term and in the three main sectors
- Regeneration areas have witnessed significant compression in yields – trend in office market is consistent with faster rental growth
- Retail in regeneration areas has generally tracked the performance of the town centre retail market
- No evidence that regeneration property markets are inherently more volatile or cyclical than overall market



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# Comparison to Benchmarks

<b>Sector</b>	<b>IPD universe</b>	<b>IPD Eight City universe</b>	<b>Eight City Regeneration</b>
<b>Retail</b>	<b>11.5%</b>	<b>11.2%</b>	<b>15.8%</b>
<b>Office</b>	<b>9.7%</b>	<b>10.3%</b>	<b>10.6%</b>
<b>Industrial</b>	<b>12.3%</b>	<b>12.6%</b>	<b>12.6%</b>
<b>All property</b>	<b>10.2%</b>	<b>11.0%</b>	<b>12.8%</b>



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# Analysis of Risk

	Retail	Office	Industrial	All Property
Regeneration areas, SD	9.05	9.15	10.20	8.51
UK benchmark, SD	7.26	10.68	9.79	8.70
Regeneration areas, CV	0.57	0.86	0.81	0.66
UK benchmark, CV	0.63	1.11	0.80	0.85

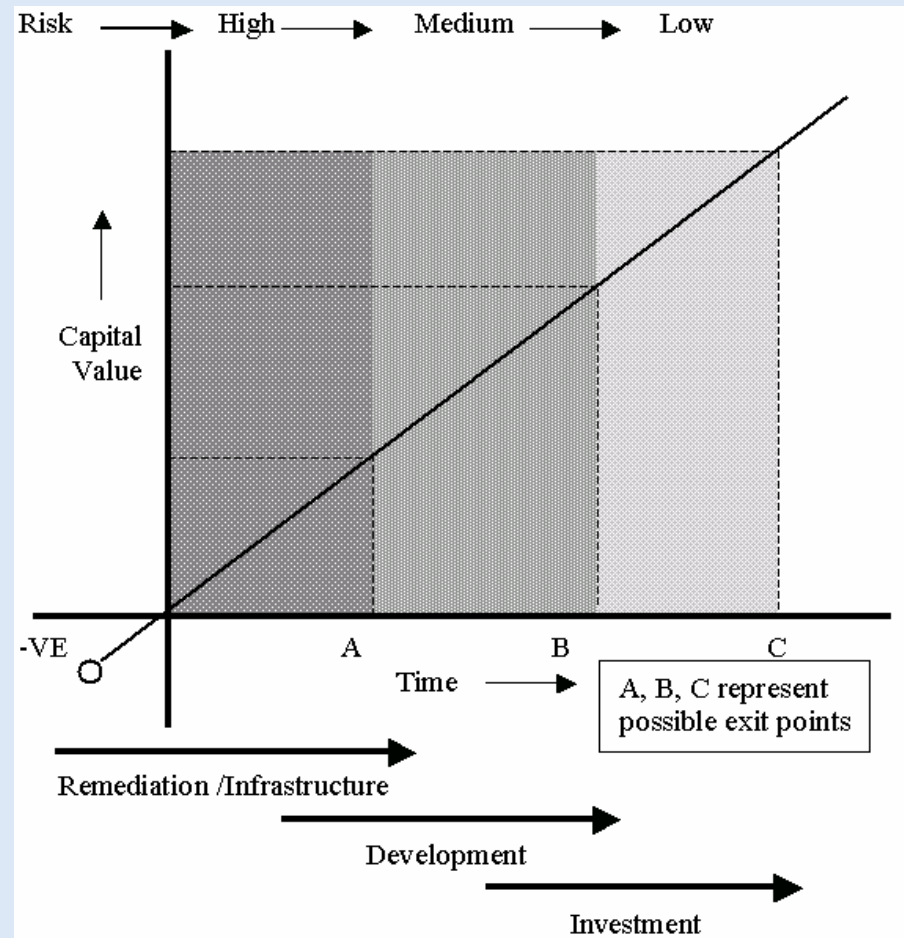


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# Strand 3 Regeneration Investment Vehicle

- Market offers a range of regeneration funding vehicles supported by institutional finance spanning single scheme vehicles through to financing portfolios of schemes
- Investors are now increasingly looking for new investment opportunities offered in brownfield locations and regeneration areas
- Largest regeneration vehicle in UK, and possibly Europe, in Morley's Igloo Regeneration Fund with £2.5 billion (US\$ 4.4 billion) of gross assets
- English Cities Fund, a joint venture of English Partnerships, Amec Developments and Legal & General is considerably smaller and is restricted to regional assistance areas

# Regeneration phases and risk profiles



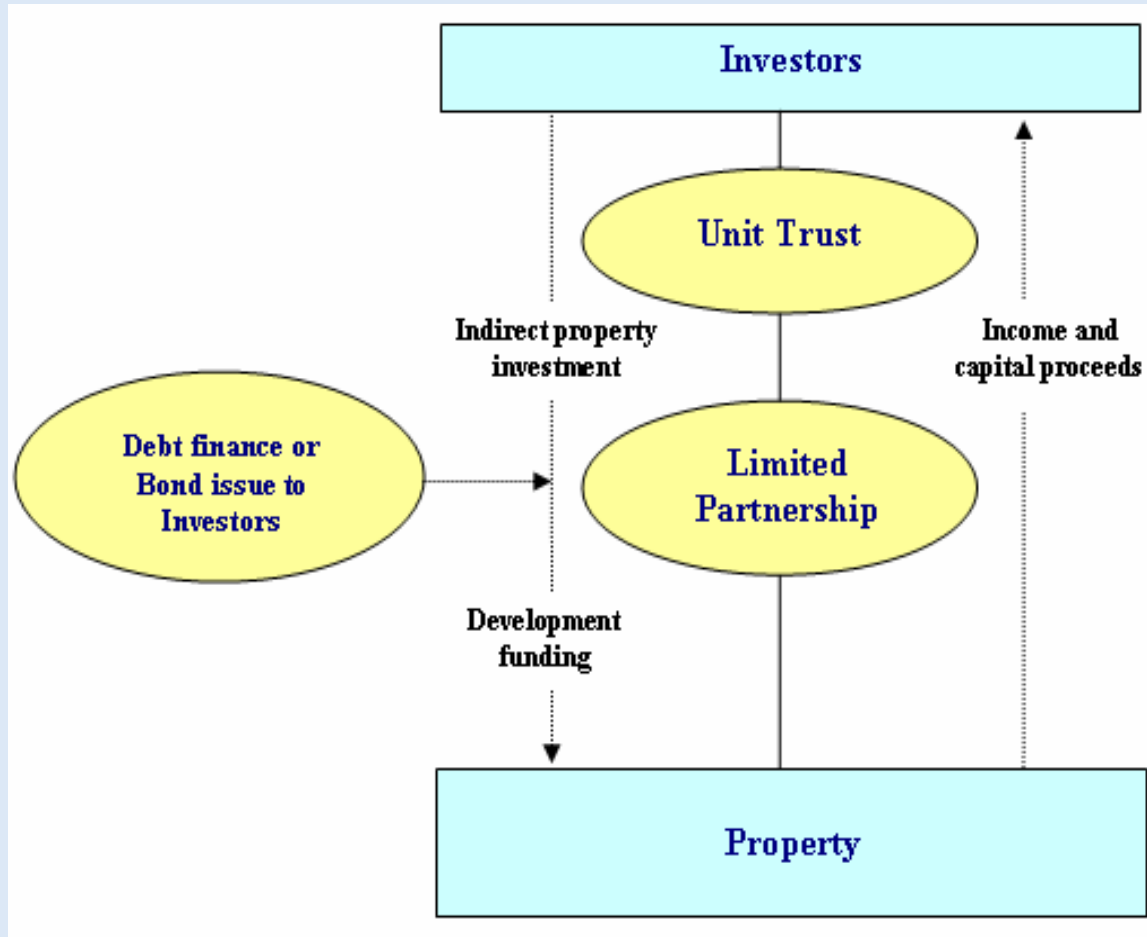
# Institutional involvement in the three phases of regeneration

Regeneration Phase	Main activity	Characteristics	Institutional involvement	Funding Options
Remediation / Infrastructure (2 to 5 years)	<ul style="list-style-type: none"> <li>• site assembly</li> <li>• site remediation</li> <li>• freeing-up development potential through infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• high cost</li> <li>• high risk</li> <li>• potential for high return</li> <li>• major uncertainty over end value</li> <li>• low liquidity</li> <li>• low transparency</li> <li>• medium timeframe</li> </ul>	<ul style="list-style-type: none"> <li>• some investment from direct/indirect property allocations</li> <li>• some institutional activity through bond issues</li> </ul>	<ul style="list-style-type: none"> <li>• Higher yielding or 'protected' bonds</li> <li>• Indirect property investment</li> <li>• Private equity is a possibility, but long lead time, low liquidity, nil income and uncertain capital values may not match many investors' objectives.</li> <li>• Bank finance</li> </ul>
Development (2 to 5 years per phase)	<ul style="list-style-type: none"> <li>• construction of the property asset</li> <li>• letting of the property to tenants</li> </ul>	<ul style="list-style-type: none"> <li>• debt-financed</li> <li>• high risks especially at early stage</li> <li>• potentially high return</li> <li>• lack of income stream</li> <li>• uncertain capital values</li> <li>• low liquidity</li> <li>• low transparency</li> <li>• short-medium timeframe</li> </ul>	<ul style="list-style-type: none"> <li>• bank-lending dominant</li> <li>• limited institutional involvement although some investment from direct/indirect property allocations</li> </ul>	<ul style="list-style-type: none"> <li>• Indirect/Direct property investment</li> <li>• Private equity</li> <li>• Bank finance</li> <li>• Bonds</li> </ul>
Investment (2.5+years until re-development of asset)	<ul style="list-style-type: none"> <li>• sale of occupied property asset into the established investment market</li> </ul>	<ul style="list-style-type: none"> <li>• secure revenue streams</li> <li>• capital value growth</li> <li>• lower risk</li> <li>• returns above bonds</li> <li>• diversification benefits</li> <li>• liquidity dependent on vehicle structure</li> <li>• transparency dependent on vehicle structure</li> </ul>	<ul style="list-style-type: none"> <li>• main entry point for many institutions</li> <li>• under-weight in regeneration property</li> </ul>	<ul style="list-style-type: none"> <li>• Quoted equity</li> <li>• Indirect/Direct property investment (incl. REITS)</li> <li>• Private equity</li> </ul>

# New Vehicle Required

- The principal message from the research is that a new regeneration investment vehicle is required
- Current regeneration funds are typically established using tiered limited partnership and unit trust structures. This is because the UK limited partnership suffers from burdensome transfer tax treatment
- Often include an offshore element to overcome tax disadvantages which diminish returns and affect viability

# Traditional Investment Vehicle Structure



# Regeneration Investment Vehicle 1

- A Regeneration Investment Vehicle would, from a funding perspective, allow the combination of bond and indirect property investment/private equity elements coupled with traditional bank debt
- From a structural perspective the vehicle facilitates efficient management whilst offering tax efficiency, liquidity and flexibility to investors
- A viable fund model that can meet most of the funding and structural objectives

# Elements and Potential Parameters of a Regeneration Investment Vehicle

Bond Element	Purpose of raising up front capital Possibility of linking to PFI-type infrastructure projects
Bond rating	Investment grade
Issuer/ Covenant strength	Various options including Govt backed/LA backed/credit enhanced/insurance wrapper
Holding period	20+ years (to allow for development)
Pricing/risk premium	Gilts + 60-110bp
Liquidity	Trade-able
Payment of coupon	Fixed or variable coupon
Benchmarking	Against gilts
Fund size	Minimum £200 million per issue
Gearing	Balance from private equity and bank borrowing
Return requirements	Govt backed - LA gilts + 1-2%/PFI projects gilts + 3%



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# Elements and Potential Parameters of a Regeneration Investment Vehicle

Indirect Property Investment/Private Equity Element:	Purpose of funding development phase – capital gain & income Higher risk and higher return
Holding period	Rolling 3-5 years in the case of private equity; longer in the case of indirect property investment
Fund size	Minimum £100 million
Return requirement	Mid-teens +
Possible structure	Combination of existing/new co-investment vehicles
Liquidity	Limited
Benchmarking	Absolute returns
Exit strategy	Sell to new investor
Long-Term Funding Element	Comparable to direct property investment
Pricing	NAV of scheme would dictate price
Exit strategy	Exit points at any time

# Regeneration Investment Vehicle 2

- Form of vehicle - UK based investment trust (similar to a REIT)
- Benefit from tax transparency and transfer tax rates comparable to equities to encourage investment and a liquid market
- Scope of permitted activities would allow the development of and investment in “qualifying” regeneration projects
- Vehicle would secure finance from banks and investment from fixed income (bonds) and property institutions in order to invest across all phases of the regeneration process
- A number of Regeneration Investment Vehicles should be set up operating on a project by project basis

# Regeneration Investment Vehicle 3

- Bonds component could take a number of forms, ranging from conventional issues (wrapped or unwrapped) secured on the schemes to Government-backed issues funding infrastructure
- Opportunity to issue bonds with returns linked to an IPD index or to the value of the underlying scheme
- Various sources of finance would be likely to invest in a Regeneration Investment Vehicle provided it is suitably structured to meet their differing demands for returns and appetites for risk
- An essential requirement will be an expert and experienced management team

# Conclusions

- **Perceived total return is the primary factor influencing investment**
- **Perceptions of high levels of risk and negative returns are the principal barriers to investment in regeneration**
- **Commercial property in urban regeneration areas has delivered significant returns over the longer term and in the three main sectors**
- **No evidence that regeneration property markets are inherently more volatile or cyclical than overall market**
- **Evidence shows a substantial weight of institutional money that could be attracted into regeneration**
- **Greater understanding is required of regeneration as a 'hybrid' investment possessing return characteristics of equities and bonds**
- **Regeneration Investment Vehicle required to deliver more institutional finance**