



Attracting private finance into urban regeneration

Private sector investment is an essential component in the effective delivery of urban regeneration and represents a central theme in current government policy. However, urban regeneration traditionally has been perceived as a high-risk, low-return investment. This study by researchers in the Centre for Property and Planning at the University of Ulster examines the use of initiatives, influences on investment decision-making and perceptions of those involved in the regeneration process. The main findings of the study are:

- f** The experience of investors in urban regeneration indicates the achievability of high returns.
- f** Developers, as short-term risk takers, occupy a pivotal position in terms of stimulating initial confidence in the property market and in creating opportunities for longer-term investors.
- f** Measures which are not in themselves based on financial considerations are important in creating an environment which will stimulate the flow of private finance into urban regeneration.
- f** Contaminated land is a high risk factor in terms of liability to developers and short-term financiers. Its remediation is critical to the re-use of brownfield sites and the leverage of investment into urban regeneration locations.
- f** There is evidence of increasing acceptability of partnership arrangements by the private sector in the delivery of urban regeneration. However, to offset risk and ensure confidence such arrangements need to be flexible to achieve cross-fertilisation between business and community goals.
- f** A more effective transfer of the Private Finance Initiative (PFI) model to urban regeneration is required to increase participation by smaller-scale development companies focusing on lower value projects.
- f** The rationale for non-investment in urban regeneration includes the perception of weak market demand, the adverse quality of neighbouring environments and added management problems associated with urban regeneration projects.

Over the past two decades improvement of the physical, social and economic fabric of cities within Britain has become a core policy issue. The leveraging of private finance and investment into urban renewal is increasingly important due to the constraints on public sector resources. However, little research has been undertaken into the mechanisms for attracting private sector finance into urban regeneration or analysing the motivations, risks and returns of investors compared with those who have not invested into such schemes. This study examines these issues, making use of the following specialist terms:

- **Short-term development finance**—funding provided by a commercial or merchant bank to a developer or borrower to create a property asset in which the rate of interest reflects the nature of the project, the quality of the scheme and the financial status of the developer/borrower”
- **Long-term development finance**—funding provided by insurance companies, pension funds and to a lesser extent property unit trusts, charities and private investors which is normally less expensive than short-term finance”
- **Land (site) assembly** “the process of parcelling by designation and acquisition the land and property to be regenerated”
- **Pre-lets/letting** “a risk reduction measure which secures key or anchor tenants for developments within a regeneration scheme”
- **Exit strategy/route** “a risk reduction measure which enables the investor to capitalise on the investment”

Investors in urban regeneration

The market downturn of the early 1990s was characterised by an increased targeting of investment into Urban Development Corporations (UDCs) reflecting the perceived cushioning effect of the initiative. A corresponding but lower level of investment activity is observed for Enterprise Zones, suggesting their focus upon fiscal-based measures is less attractive in stimulating the flow of private finance. English Partnerships facilitated the integration of different grant regimes, with the relatively high proportion of companies involved in City Grant funded projects underlining the emphasis upon grant-based initiatives. Although City

Challenge and the Single Regeneration Budget (SRB) have been in operation for a relatively short time, the analysis indicates that these are as effective as UDCs in terms of attracting private finance. Indeed, partnership arrangements with community groups now seem to be perceived more favourably by the private sector. Furthermore, a significant growth in the use of European Structural Funds highlights the increasing awareness by both public and private sectors of this source of finance within urban regeneration projects.

Perceived total return is the primary factor influencing investment decisions. Those companies which retain their investments within urban regeneration locations do so in expectation of achieving above average returns. A further significant factor is the perception of investment security and the spreading of risk, though the analysis indicates that investors attach greatest significance to return as being the primary motive for holding an urban regeneration portfolio. Other factors of importance include new business opportunities and a transparent exit strategy. Track record in urban regeneration and relationship with regeneration agencies are more middle-ranked considerations and, although important at the development stage, seemingly do not arise as major influences in companies’ motives for holding urban regeneration portfolios over the longer term.

Rental growth arising from occupier demand and capital appreciation reflecting investor demand are the primary factors by which new urban regeneration projects are evaluated. The level of risk and physical quality of a development are also considered to be highly significant factors in assessing potential projects. Second-order evaluative criteria include the long-term sustainability of projects, an appropriate mix of land uses, land costs/construction costs, the environmental quality of contiguous neighbourhoods, suitable powers to facilitate site assembly/land packaging, and the availability of grant regimes. Regeneration initiatives are of a secondary nature in terms of those criteria which influence investment decision-making, with site assembly, grant regimes, partnership structures and taxation breaks middle- to lower-ranked factors. The research suggests that investors do not initially evaluate projects on the basis of regeneration mechanisms in place but consider projects in a similar way to other commercial enterprises.

Non-investors in urban regeneration

The principal reasons for non-investment in urban regeneration include the perception of bureaucratic grant regimes, negative image of neighbouring environments, lack of or low rates of capital appreciation and/or rental growth. Other factors include perceptions of added management problems, the insufficiency of grant regimes to offset risk, the inflated nature of construction and land costs, the inappropriate structure of taxation breaks, the failure of urban regeneration locations to adequately market themselves and the failure of site assembly mechanisms to reduce risk. It is apparent that non-investors in urban regeneration place a higher degree of emphasis on the spreading of risk. The greater aversion to risk is an important characteristic in differentiating between non-investors and investors into urban regeneration.

Non-investors nevertheless show a general recognition of the effectiveness of grants to facilitate urban regeneration. Likewise there is a measured degree of support concerning the perceived merits of public-private partnerships in delivering development opportunities within urban regeneration locations. This perception is qualified by the opinion that a greater degree of flexibility is required to facilitate cross-fertilisation between business and community goals.

The quality of neighbouring environments acting as a deterrent to investment has a relatively strong influence on decision-making. In contrast, there is a low level of concern regarding the quality of development schemes in urban regeneration locations. Furthermore the quality of the social infrastructure as measured by the labour force is not perceived to be a negative factor, with only a minority of respondent companies identifying poor quality labour in urban regeneration locations as a deterring factor.

Factors required to improve the flow of private sector finance

Funding initiatives are core elements of concern for companies actively involved in urban regeneration, in particular clarity in procedures in implementing PFI and the simplified administration of funding in relation to grant-based schemes. Concerning the former, the survey of urban regeneration investors suggests a lack of knowledge regarding the transferability of PFI to urban regeneration projects. Furthermore, contamination remediation is considered by investors in urban regeneration to be a

major influence in helping to unlock the flow of private sector finance. Indeed, the importance of this is highlighted in the investor survey by a weighting marginally in excess of the other factors, including funding characteristics. Other measures perceived to be important include a guaranteed minimum standard of infrastructure, clarity in public policy and processes, targeting of initiatives according to the private sector's priorities and commercial requirements, simplified planning procedures, and land assembly.

In the case of non-investors in urban regeneration a similar range of factors required to improve the flow of private sector finance is identified. While not financial variables in themselves, there is a synergy and complementarity between these factors which are perceived as necessary in creating a more secure investment environment.

Institutional investors set very high criteria for alleviating risk when considering investment in urban regeneration areas. In contrast the property investment companies appear to have lower requirements suggesting that they are more amenable to facilitating the financing of urban regeneration. In contrast property development companies seem to adopt a position between property investment companies on the one side and institutional investors on the other. This group occupies a pivotal position in the identification and creation of development opportunities thereby facilitating the flow of long-term investment finance.

About the study

The research examines the motivations of investors and non-investors in urban regeneration, analyses the mechanisms used for mitigating risk and evaluates those factors that attract private sector finance or which act as a constraint upon the flow of investment in urban regeneration.

The research methodology consists of two interrelated strands; namely, focus groups discussions and questionnaire surveys of investors and non-investors in urban regeneration. The focus groups were conducted in Manchester, Newcastle and the Lee Valley, London. The questionnaire survey was targeted at property funders, institutions, development companies and other interests.

How to get further information

The full report, *Accessing private finance: the availability and effectiveness of private finance in urban regeneration*, is available from RICS Books, RICS, Servale Court, Westwood Way, Coventry, CV4 8JE (Tel: 0171 222 7000, price £9.95 plus postage and packing).

The following *Findings* look at related issues:

- Housing associations and the private lender, Sep 96 (*H192*)
- Index of private rents and yields, Sep 96 (*H194*)
- The prospects for large-scale investment in residential property, Oct 96 (*H195*)
- Housing association investment on local authority estates, Nov 96 (*H199*)
- The redevelopment of contaminated land for housing use, Oct 97 (*H225*)

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