PREPARING FOR RECOVERY: REGENERATING OUR WAY OUT OF RECESSION

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INTRODUCTION

Here we are in another property recession. This is my fourth. I suspect there is still time for another one to come along to give me 5 in an innings. Also I feel that despite early signs of recovery this one is probably not yet a dead rubber. The suggested title of this paper was "Regeneration in a recession" but I prefer to put a more positive spin on things and look at ways in which we can work our way back to recovery.

The last time that I shared a platform with Ken Dytor (see the previous paper) was Platform 9 at the Gare de Lyon en route to MIPIM, a conference where property consultants from the private and public sectors have an opportunity to share experiences of the market. I believe we are all consultants. Those from the private sector regularly consult to the public sector, whilst those of you working for Local Authorities are also consultants, providing consultancy advice to your political masters, who then decide whether to accept that advice, or to pursue some alternative political agenda.

Politics

Whilst it seems likely that we will see a change of Government in 2010, whatever the political hue, we are certain to see cuts in public spending that will affect all of us and hinder the drive to regenerate our way from recession into recovery. It is widely reported that shadow chancellor George Osborne will present a "cuts" budget within weeks of coming to power. And the news from the TUC Conference is that Gordon Brown has for the first time talked overtly about "cuts" in public spending

What might be the likely Tory policies? It is probable that they will abolish the RDAs, perhaps with one or two exceptions. Instead RDA resources will be devolved to Local Economic Partnerships. These could be organised on a sub regional or city region basis depending upon what Local Government decides. This then raises the opportunity for Local Government to take a much closer role in regeneration within its own communities, rather than competing for diminishing funds on a regional basis. There are also indications that an SRB type fund will be created, but, as yet, there is no indication as to which Government budgets will be merged into the fund.

What does seem clear is that the Regional Spatial Strategies will be abolished, but the Local Development Frameworks will be strengthened to accommodate a new build initiative where six years up front Council tax payments will be made for each new build dwelling. Sub regional coordination of planning will be a local decision, not centrally imposed.

The key Tory theme on regeneration going into the election will be "Fixing the Broken Society". Worklessness and benefit dependency will become the central themes of regeneration programmes; so regeneration drivers will change. The Tories would also like to introduce TIFs and Accelerated Development Zones but as yet have not identified funding to develop these ideas. Borrowing ideas from the other side of the Atlantic has not always been a resounding success, as REITs have shown. And we must remember that in the US Local Government retains business rates; they are not ceded to Central Government for redistribution as it sees fit.

It is probable that there is a rethink going on in relation to social housing tenancies and perhaps even to excluding some groups who are hard to manage, given the public comment on Anti Social Behaviour and benefit dependency.

They will have a "devolution agenda" with local communities being given control of spending in their neighbourhoods. There has been talk of Community Land Trusts, and the Tory Party has been taking soundings on whether people feel that these are useful models to continue future neighbourhood work.

Above all by September 2010 the regeneration landscape will have changed. It has already changed in the face of market changes. There is an unprecedented fiscal deficit, 57% of GDP as at September 2009 that must be addressed. Many of the changes that will come, whoever wins the election, are likely to return more control and responsibility to local communities through Local Authorities. This will put Local Government in the vanguard of regeneration programmes although it is plainly apparent that the financial resources available to you will be constrained. One thing Local Authorities need to guard against is the devolution of Central Government responsibilities without a commensurate shift in the balancing revenues.

How more regeneration can speed recovery

Earlier papers in this series outline the economic overview and outlook and I, as a mere surveyor, could not presume to contradict them. In simple terms, from the start of 2009, the market remained impacted by a lack of debt funding for development proposals. What was almost more relevant was that even where debt was available, the debt to equity ratio had changed from 9:1 at the peak to about 2:1. This means that developers need to find about 5 to 10 times the level of equity to invest in projects that they had previously needed to find. This has caused many projects to be put on hold, whilst viability was reviewed against a falling market.

As the year has unfolded developers have become more accustomed to this change in financial circumstances. Unfortunately, development is a slow process and the ability to turn things around to facilitate higher equity levels has proved to be difficult, and the mezzanine debt providers have been extremely cautious. The situation has been further undermined by continuing business uncertainty and rising unemployment thus damaging further the viability of many schemes. Nonetheless, as we end Q3 of 2009, there is evidence that developers are gearing up to be able to secure an acceptable level of project debt, albeit that projects are also being affected by other matters. But most will not take the first step without more comfort than they may have required in the past, for example, significant pre-lets.

The last part of Q2, and all of Q3, has been marked by a return of house builders to the market. Through options and conditional contracts they are seeking land principally for purchase in 2011 and beyond thus giving themselves 18 months or so to secure planning consent and so be ready for a resurgence of the residential market. This confidence has been borne out by recent increases in house prices as recorded over the summer. But no longer will we see high-density residential driving town centre regeneration. The need for housing remains, but so does the memory of the past two years, and the thrust of the housing recovery is back to basics by the house-builders; ie family housing in a suburban setting; doing what they know best. We will see housing developers go back to being house builders.

There are a number of Local Authorities, however, that have been left with stalled schemes due to developer's funding fallout, decisions not to start schemes, and developers (and in some cases Local Authorities' partners) failing. There will still be a need to deliver these schemes, as well as meeting Government targets on such things as housing.

Partnering

The key to getting regeneration moving again, particularly in the face of reduced public spending, is finding a way to kick start these stalled schemes, and partnering with private developers, hopefully buoyed by increasing debt finance, will be the key to delivery. This means partnerships in both directions; bringing in a private developer to work with the Council, as well as the Council joining in private developer schemes. Share the risk and also share the reward.

In the past decade or so we have all learned some valuable lessons about the partnering process. Here I would like to add one or two pointers of my own that will hopefully help facilitate the process. Firstly public authority organisations have one important asset that is not used often enough to stimulate regeneration. This is your valuable blue chip covenant.

As I have already mentioned, the reliance upon the inclusion of high density residential to underpin mixed-use regeneration is a thing of the past. We need to look elsewhere and I urge you to consider how the Council's estate can be brought into regeneration schemes, for example.

- Is there property in your portfolio or a property that you occupy that could itself be ripe for redevelopment?
- Are there local organisations that need rehousing and are coming to the Council for help?
- Can the Council be the pre-let that will stimulate and pump prime the regeneration scheme?
- Substituting Council occupied office space for planned residential within a scheme can potentially be achieved with minimal change to the external envelope for which planning may have been granted, and in this market, there is opportunity for the Council to secure benefits of first mover advantage, sharing in the success of the scheme, as well as the benefits of stimulating the regeneration.
- Croydon Council has successfully achieved this in the CURVe partnership with John Laing, one of the first LABV projects to go live.
- Too often we hear of Local Authorities looking at edge of town business park sites for their own occupation whilst, at the same time crying out for town centre stimulus.

Whilst on the subject of Council occupation, remember that investment markets too have been hit by the credit crunch, leaving the prices for investment at a modern day low. There has never been a better time to consider taking advantage of this. Where a Council is occupying leasehold property, I would strongly recommend exploring the purchase of the freehold, such as Edinburgh City Council has done. With borrowing rates significantly below investment yields, such an exercise will quickly be revenue positive, even after capital amortisation.

The principles of public regeneration projects

Here it is important to engage with the private sector and in doing this, there are a number of pointers that I have identified, based upon practical experiences of partnerships between the public and private sector.

- **Get the OJEU process right.** We are all aware of Roanne and the last thing anyone needs is to have to go through the process all over again. Notoriously, most developers have little knowledge of the process, so getting it right first time will get them on side.
- **Make the tender brief as clear and detailed as possible.** Too many tender documents are pulled together in a hurry and without properly explaining quite what is required. Be as specific about what your requirements are as early as possible, and do not leave it vague on the basis you will sort it out later.

- **Try and get full officer support.** We have seen a number of joint ventures between the public and private sector that have been unnecessarily delayed by a planning process that is frustrating to both parties. Try and get buy in from planning colleagues at an early stage and involve them in the whole process
- **Cross party member support is important.** Remember most regeneration projects last more that 4 years and are thus susceptible to changes of control within the Council
- **Keep the documentation tight.** In so many instances, the Council Legal Department is expected to be experts in all areas of law. Often non specialist Council lawyers draft complex development agreements that later either a developer will ride roughshod over, or worse still will be proved inoperable by both parties. It is worth the cost of engaging a specialist lawyer, even to work alongside the legal department, to deliver a robust development agreement that works for both parties
- **The developer is your friend.** And you are his. Too many agreements slip into a standoff when team working could have resolved issues before they even become issues. Ensure every effort is made to maintain good working relationships.
- **Expectations are critical.** Make sure that at an early stage each party fully understands the others expectations. There is nothing a developer dislikes more than a late request to incorporate something new into the scheme, or the appraisal, and nothing annoys a Council more than a developer springing a surprise when the project is well advanced.
- **Timing is important.** It is extremely frustrating to a developer (and I suspect a Council development surveyor) to be waiting for a decision to be made which is delayed for political reasons, or because a committee runs out of time. Specific delegated powers must be created to allow commercial decisions to be taken in a commercial timescale.
- **Profit is not a swear word.** I have sat through many meetings where the developer is trying to dress profit up as something else. Profit is a fact of life and we all live with it. The first question to ask a developer is, what is your expectation? It is better to have someone deliver a good scheme for a good profit rather than a poor scheme on a shoestring. It is a reward for risk, as well as management, so the profit should reflect all aspects.

LABVs (Local Asset Based Vehicles)

Whilst the LABV is not suitable for everyone this method will, in my opinion, remain a popular way of delivering regeneration. LABV use has been constrained recently, by funding and falling property values, leading to, for example, the cancellation of Glasgow City Council's proposed LABV. But there is a strong case for reconsidering these vehicles in anticipation of rising values and greater liquidity that should come in by the time the project is ready to go live.

Over the last 40 years various structures have been used by the public sector to bring forward and develop publicly owned land with the least amount of public subsidy; the latest of which is the Local Asset Backed Vehicle (LABV) along with subsidiary variants; Local Housing Companies (LHCs) and Public Regeneration Partnerships (PRPs).

Put simply, the LABV is a joint venture vehicle with an extended (10-20 year) life span, usually taking the form of a Limited Partnership (LP) or a Limited Liability Partnership (LLP) into which the public sector partner injects land assets, the private sector partner injects development skills and equity, and a third party bank/institution or other body injects finance/grants. The partnership vehicles are corporate entities in their own right and can borrow on a non-recourse basis without liability to the partners (other than as to the assets injected). They are then used to develop a wide spread of public sector sites, from an initial portfolio through to new sites.

The initial procurement provides for the possible injection of new assets into the vehicle over time to meet the objectives of the partnership. Within the 50/50 vehicle, both the public and private sector put in matched equity, and take equal risk for equal reward. This is the key difference from historic methods of disposal and partnering. In the LABV, the public sector is a long-term partner in the development of its own land and shares in the risks and rewards whilst a Limited Liability structure provides protection from claims on assets outside the vehicle. Meanwhile the private sector, rather than being in an adversarial relationship, becomes a joint venturer within the umbrella of the LABV and have interests directly aligned with those of the public sector.

The LABV joint venture structure was developed as a response to the perceived problems of the other methods of disposal in meeting the wider objectives of the public sector in the disposal of land. The following public sector objectives regarding their estates are attainable.

- To achieve both best value and value for money for the public sector from the sale of its land interests
- To achieve defined regeneration outputs, physical, financial and non-financial
- To dispose of land by way of an OJEU compliant, transparent procurement process
- To participate in the uplift in value of land over time
- To undertake development of public assets using private finance on a non-recourse basis
- To maintain a level of control in the land going forward

- To establish flexible, long-term partnership arrangements into which future assets can be injected on a similar partnership basis
- To provide vehicles that are capable of capturing regeneration grant funding
- To provide access to equity on a wholesale basis for the life of the vehicle

Whilst the partnership agreement cannot force the partners to develop, the consequences of not doing so are so heavy and bear particularly on the private sector, making it extremely unlikely that the physical delivery of the agreed objectives will not occur. The LABV model is evolving to meet the new market reality. The preference of the public sector will always be to retain ownership of their assets and the LABV allows the public sector to meet the majority of its wider aspirations, meanwhile removing some of the political banana skins from the regeneration process.

Over the coming years I am sure we will see a range of innovative funding options for Public Sector regeneration coming forward, and LABVs is just one of the first. But generally the way to approach regeneration is through innovation.

Experience Retail

Paul Ellis's earlier paper discussed the issues that town centres face and concluded that the town centre will remain the heartland of regeneration programmes. But regeneration does not have to be about rebuilding, it can be as much about the way we use our assets. In acknowledging this, we have been developing what we call Experience Retail.

Experience Retail is a new form of place for shopping, leisure and entertainment. So what has really been happening in retail development around the globe? If consumer trend analysis from specialist retail developers is any guide, there is a paradox at work, especially since the credit crunch began to bite.

The first trend is that in developed economies, most visibly in the US and the UK, consumers are spending less. In parallel, the research is showing that consumers now regard shopping as a form of leisure and entertainment and are looking to spend more time in places which offer them a mix of experiences such as shopping, leisure, entertainment, sports, cultural facilities and even access to heritage attractions in one centre or place. It is for these locations that we have coined the term "Experience Retail".

Experience Retail is not just a loose combination of shops in a big box with a few leisure add-ons such as a multiplex cinema and a bowling alley, now almost a standard for many out-of-town retail developments. Experience Retail is a more sophisticated offer, a place where consumers can satisfy many of their needs, wants and aspirations for the products, services and experiences that they require for their lifestyle and self image, combining innovative ways of delivering the retail experience together with the leisure, entertainment and cultural experiences and residential lifestyle.

In the delivery of the service in the retail environment, Experience Retail provides a more personal and higher quality service, with staff who really do know about the products they are selling, who designed them, where they are made and which are backed up by the latest technologies.

A recent publication summarised research on changes taking place in consumer behaviour. What it found was that consumers wanted to accomplish more in less time and that:

- Shopping is evolving into an experience
- Retail is becoming part of the "entertainment industry"
- Shopping is a way for people to express themselves
- Shopping associates people with desired lifestyles
- Aspirational brands are becoming more important and
- The physical retail experience should be entertaining and authentic.

For consumers with money, and even those on temporarily reduced budgets, shopping is becoming more "fun" than "run". Consumers increasingly desire experiential pleasure and feel-good sensations from consumption; they are spending more money on quality experiences than on material goods and, to address this product manufacturers have recognised that they need to offer consumers experiential sales environments. And Experience Retail is not just about shopping centres. Your high street, too, can be an Experience Retail destination.

Conclusions

In my opinion whilst the economic impacts will continue to affect the regeneration pipeline for some time I remain positive for the future. The way forward is to be innovative, to try and seek new ways to deliver regeneration and look to a partnership approach as being the best way to ensure your aspirations can be met.

I believe that the "credit crunch" has provided a brief interlude to the regeneration agenda, and I offer you all hope for the future. Our collective experience proves that regeneration is not a quick fix or by any means an easy option.

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