D x V x F > R? New Models for Development in an Age of Austerity

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Introduction

Following a prolonged period of strong economic growth and decades of single party Government, the country is slowly getting used to the new reality in which it finds itself: the first Coalition Government since the Second World War and a new age of austerity.

The combination of these seismic changes will both require and produce radical change—the Government is already embarking on the implementation of what the Prime Minister and Deputy Prime Minister have termed: “a radical redistribution of power from Government to communities and people, to reverse decades of over-centralisation”.

This paper focuses on some of the ways in which these changes could impact upon the delivery of new development, housing and infrastructure. It considers how the property industry can respond to the Government’s challenge to innovate, to deliver “more for less”, and to frame new delivery models which support the country’s economic recovery.

The Change Equation

In the 1970s, two leading thinkers in the field of organisational development, Richard Beckhard and David Gleicher,[1] set out to consider why some organisations were highly successful in implementing change, whilst others were not. Their work culminated in what is now known as the “Change Equation”.

Beckhard and Gleicher observed that successful change was only achievable when the following equation was observed:

$$D \times V \times F > R$$

where:

- D represents the dissatisfaction with how things are now;
- V is a vision of what is possible;
- F refers to the first concrete steps that can be taken towards achieving that vision; and
- R refers to the resistance that change (or “doing things differently”) creates.

In this equation, D, V and F are multiplied, because if any one of these is either absent, or has a low value, then the product of D, V and F will be low and not capable of overcoming the resistance to change.

Thus, Beckhard and Gleicher concluded that for real and lasting change to take place within an organisation, the dissatisfaction with the current situation when combined with a vision of what could be achieved and an understanding of the first steps towards a better solution, has to exceed the resistance to implementing those first steps.

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[1] Richard Beckhard, *Organisation Development: Strategies and Models* 1969.

The Change Equation has been adopted by many of the world's largest companies when implementing major change management programmes. In developing those programmes, companies ensure D, V, F and R are built into their plans and, during the process of implementing change, the Change Equation is used as a tool for considering why teams resist change.

This paper seeks to apply the Change Equation to the property development sector, where major change is now required to enable the sector to successfully develop in the current economic and financial conditions.

D—Dissatisfaction with how things are now

Developing and investing in property is a long-term business. Long-term businesses need a stable operating environment. Whilst developers and housebuilders have historically benefited from a long period of economic growth and generally stable financial markets, we have been bombarded with all manner of change by the Government of the day. Those changes have had most effect on the interface between developers and the public sector, where a significant number of developers operate (most development needs the involvement of the public sector in one form or another), and have included:

- Successive ministers have introduced a plethora of new initiatives and delivery bodies, resulting in overly complex delivery arrangements. By way of example, how can the 40 bodies with planning powers currently operating in the Thames Gateway facilitate the delivery of the Thames Gateway in a seamless and joined-up manner?
- Acronym anarchy: from LABGI to LEGI, from LAAs to MAAs. Some have been useful, but many have simply tinkered around the edges. They have dealt with the pennies, and not with the pounds needed to deliver in our highly complex environment.
- Government inconsistency on policy issues. Planning Gain is a good example, as we have moved from s.106 via tariffs to PGS to CIL to …..? Other examples include a range of central and local government initiatives, including regional assemblies (introduced then abolished), national housing targets (introduced then abolished), RDAs (introduced then abolished), LEPs (to be introduced), EP (introduced and then replaced) and many more.

Despite all these changes, introduced no doubt because successive Governments thought they were improving and facilitating development, we still are not getting it right. Major pressures within our delivery systems are affecting Britain's ability to provide new critical infrastructure, develop new commercial space and build new homes. The facts speak for themselves:

Infrastructure

The United Kingdom's national infrastructure, much of which is needed to underpin property development (roads, telecoms, water, energy, etc), is suffering from a lack of long-term planning and decades of underinvestment. In a 2009 paper, the Policy Exchange think tank concluded that some £500 billion would be needed to be spent by 2020 to renew and replace much of Britain's tired infrastructure, in order to improve the country's competitiveness, stimulate economic growth and meet the challenge of climate change.[2]

Another think tank, Reform, also reported last year that:

[2] Dieter Helm, James Wardlaw and Ben Caldecott, *Delivering a 21st Century Infrastructure for Britain*, (2009) Policy Exchange.

"…the UK is in the infrastructure slow lane, rated 34th behind Namibia and Spain, despite being the 6th richest country in the world. The OECD's most recent survey of the UK economy found that inadequate investment [in infrastructure] is a key reason for low productivity—Britain spends less on this area as a proportion of GDP than any other OECD country."[3]

This matters for two reasons. First, there is a strong link between a nation's investment in critical infrastructure and its economic growth and development.[4] For example, the US Federal Highway Administration estimates that every $1 billion invested in transport infrastructure creates 47,000 new jobs and generates up to $6 billion in additional gross domestic product, a multiplier of six.[5] Secondly, the United Kingdom's over-stretched infrastructure will eventually constrain the country's economic growth. For instance, it is well-known that the quality of local infrastructure is a major consideration in where businesses locate, and by implication where property is developed.

Investment in economic infrastructure should be a key plank of the United Kingdom's recovery plans. The Government's retention of Infrastructure UK to advise on the country's long-term infrastructure requirements is a welcome move. However, new sources of investment are urgently needed and the property sector has a role to play in promoting new initiatives for sourcing that investment.

Commercial development

Development activity has been heavily constrained by the very hostile financial and economic backdrop of the last two years. Yields increased sharply in response to the recession, lowering the projected end values of development, rents fell and voids increased. Construction costs that rose sharply up until 2007 only began to fall in late 2008, and still remain high. The City of London provides a good example. In the City office market, prime rents fell by a third from their peak in 2007, rent-free periods more than doubled, investment yields moved out by 250 basis points and transaction levels were down significantly. As a result, commercial development starts fell dramatically: in the 12 months to the end of Q2 2009, there were only 1 million sq.ft. of construction starts compared to 6.6 million in the preceding 12 months.[6]

Whilst there has been some recovery across the market during the last year, that recovery has been partial and uneven with performance across sectors, regions and quality of stock, varying dramatically. Some of the variation in performance is attributable to the "flight to quality" which has been a feature of the market in the last 2–3 years. But two major issues continue to dominate the commercial development market:

The burden of planning obligations and regulations

During a period of sustained economic growth, strong demand and rising land values, the burden of planning requirements and obligations grew steadily. There is no better example that Ken Livingstone's 50 per cent affordable housing policy. Today, with rising yields, falling rents and lower out-turn valuations, many development schemes are simply no longer viable when the burden of planning regulations and obligations, including of course the costly sustainability measures now required and proposed, is taken into account. Land values struggle to support these cumulative costs, which in turn make development unviable.

[3] Bosanquet, Cawston, Haldenby, *Road to Recovery* (2009) Reform.

[4] An interesting discussion of the impact of investment in transport on economic growth is to be found in *The Eddington Transport Study*, HMSO, December 2006.

[5] Phil Davis, *Financial Times*, September 5, 2010.

[6] Kevin McCauley, *Central London Viewpoint*, (July 09) CB Richard Ellis.

A number of local authorities are reconsidering the phasing of these contributions and looking to ease social infrastructure costs. However, many of these burdens and obligations are statutory and outside the negotiation process. As a result, there remain a significant number of major schemes which are marginal and would require substantial improvements in out-turn valuations to become viable.

The availability of bank funding

In some ways, the property markets are like a highly tuned car, with bank debt performing the same function as the car's oil. Just as oil is needed throughout the engine, bank finance is needed right across the property markets: to finance land assembly, to finance development costs, to bridge short-term funding issues, to leverage returns on the holding of completed investments, and to finance domestic mortgages.

Whilst oil helps the engine parts runs smoothly, bank finance keeps the various components of the property market trading smoothly. Remove the oil, and the car's engine seizes up. Remove the bank finance, and development activity grinds to a partial halt.

The reappraisal of risk in the post-recession world has led to the creation of a highly risk averse culture with the banking community remaining cautious in its approach to lending. A significant level of pre-lets is a pre-requisite for commercial development finance and housing schemes require a high level of guaranteed off-take prior to sales. The off-take, which would traditionally have been provided by the social landlords and the buy-to-let sector, is proving difficult. Social landlords are themselves facing funding cuts and the traditional buy-to-let markets, which might historically have accounted for as much as one-third of off-take, are still in recovery.

Where bank finance is available, loan-to-value relationships are generally tighter. This results in the need for a greater level of equity from developers, which is proving difficult to achieve in many cases.

Housing

Record amounts of public money have been spent on housing in recent years. For example, the National Affordable Housing Programme for 2008–11 was set at £8.4 billion.[7] Despite these record sums, the United Kingdom builds fewer new homes per head than any other EU15 country with the exception of Italy, and in 2009 built fewer new homes than at any time since the 1920s.[8] Yet housing demand continues to rise unabated, and too many people are still living in cramped, over-crowded and poor quality conditions. Shelter estimates that:

- 1.7 million households are on the waiting list for social housing;
- 560,000 households are overcrowded; and
- 7.7 million homes fail to meet the Government's decent homes standard.[9]

Public funding for housing is only going to get tighter and the time has come for a fresh look at how the country's housing needs can be best addressed.

Decades of tinkering with public sector structures, tired and, in some cases, inadequate infrastructure, a development sector paralysed by a lack of bank debt and over-burdensome developer contributions, and record levels of housing need which are not being adequately addressed by our current delivery mechanisms indicate the need for change. This is the dissatisfaction.

[7] See *http://www.homesandcommunities.co.uk/national_affordable_housing_programme* [Accessed September 29, 2010].
[8] Tom Aldred, *Arrested Development: Are we building houses in the right places*, (March 2010) Centre for Cities.
[9] See *http://england.shelter.org.uk/housing_issues/the_housing_crisis?_edn9* [Accessed September 29, 2010].

V—A Vision for what is possible?

> "Our first priority is Localism, and our second priority is also Localism. Can you guess what our third priority is?" Eric Pickles, Secretary of State for Communities and Local Government.[10]

The years since the Credit Crunch have been characterised by requests to Government for additional funding to support housing, infrastructure, and key commercial developments. These requests were not without success as the housebuilding industry can testify. However, the size of the budget deficit and the pressure to reduce that deficit, now mean that we are looking at the longest and deepest sustained period of cuts to public spending since the Second World War. Although we are not going to know where those cuts are likely to fall until the Spending Review later this year, it seems a reasonable bet that those areas of public spending which touch our sector are not going to be exempt.

The property industry has an important role to play in responding to today's economic conditions. At the heart of that role should be a new partnership with Government, where we work with Ministers to focus scarce resources on projects which are essential for economic growth, where we innovate, where we share best practice from around the world, where we develop new delivery models, where infrastructure investment is planned and co-ordinated, where systems are streamlined and waste is driven out, and where we produce more for less.

At the heart of the New Government's philosophy is the "Localism" concept. The property industry needs to adopt and adapt this concept in developing its new role.

The potential downside with Localism is that it risks becoming an undefined term, occasionally abused, and meaning all things to all people, much as with "sustainable communities". We are already seeing this happen. Some interest groups are interpreting localism as the right to protest about a decision to close a community hospital or to oppose a contentious planning consent. This is the interpretation of localism which has grabbed the headlines so effectively in the trade press. Whilst this may be a legitimate view of localism, the Government's ambitions clearly extend a long way beyond this very narrow definition.

It was encouraging to hear Irene Lucas, Acting Permanent Secretary at the Department for Communities and Local Government, give a view of localism stretching far beyond "nimbyism" in a recent presentation.[11] She defined localism as:

- Creating the opportunity for innovation to deliver more for less;
- Encouraging social enterprise; and
- Giving people control over decisions which affect them.

She went on to say that this would be achieved by:

- Radically reforming and refocusing government;
- Introducing a system of incentives and rewards as opposed to penalties; and
- Respecting everyone's views (summarised by Lucas as "none of us is as clever as all of us").

Whilst Lucas talked about reforming and refocusing Government, she didn't talk about what the end product might look like, leaving us to fill in the gaps. It is probable that localism will see a significant devolution of power and resources from central control to local democratic structures, albeit within an agreed framework of national minimum standards and policy priorities. If that is correct, we are likely to

[10] Jonathan Carr-West, *People Places Power: How Localism and Strategic Planning can work together*, (July 2010) LGiU.
[11] Speech delivered at the *Queen's Speech Forum* on June 10, 2010.

see the granting to local authorities and other locally accountable bodies of significant fiscal, regulatory and legal powers beginning with the General Power of Competence,[12] the introduction of Local Enterprise Partnerships ("LEPs"),[13] and the recently announced comprehensive review of local government finance.

Irene Lucas used the words "innovation", "reform", "giving people control" and "respecting views" in her speech which together present a picture of a Government prepared to listen to ideas, to accept challenge, and to think the previously unthinkable. This paper is therefore about developers, local authorities and built environment professionals proactively coming together with a blueprint for a set of new delivery models, founded on the tenets of localism, which contribute to the economic growth of the country, which help provide the infrastructure needed to catch-up with the under investment of previous years, to deliver new homes and build new commercial space. That is the vision.

F: First Concrete steps

Time to introduce another equation, the development equation:

New development = F(Land + Finance + Skills)

In other words, the sum of new development activity is a function of having enough land, enough finance and enough delivery skills.

"Delivery skills" refers to both professional and technical skills. Much has been written on this subject by better-qualified authors (the Killian Pretty report[14], Mind the Skills Gap[15]), and for that reason, delivery skills are outside the scope of this paper. The First Concrete Steps will therefore focus on the Land and Finance elements in the development equation.

Land

Development land can be assembled from both public and private sector sources. Public sector development land, which can be either identified as such or "hidden", is the focus of this section.

In the coming year, there will be at least three ways in which "hidden" public sector land could be identified and made available to help balance the development equation:

- The rationalisation of quangos will leave some "orphan" public sector land holdings. A good example is land owned by the Regional Development Agencies.
- Greater working across boundaries as promoted by Total Place[16], will highlight surplus public sector land and property.

[12] The General Power of Competence, which will give "local authorities an explicit freedom to act in the best interest of their voters unhindered by the absence of specific legislation supporting their actions", is likely to be introduced in the Decentralisation and Localism Bill in the Autumn of 2010.

[13] LEPs will become the successor bodies to England's 9 regional development agencies, although they will cover smaller areas and have fewer powers. Partnerships will provide strategic leadership and tackle issues such as planning and housing, local transport and infrastructure, employment, enterprise, the transition to a low-carbon economy, support for business start-ups and business-university links. Councils and businesses would normally have equal representation and a business leader would chair the board. Proposals are invited by September 6, with a bill due this autumn.

[14] *The Killian Pretty Review*, (2008) CLG.

[15] *Mind the Skills Gap*, (Autumn 2007) Academy for Sustainable Communities.

[16] Total Place was an initiative introduced by the last Government in 2009 to consider the extent to which a range of public sector bodies (e.g. fire, police and rescue services, the local authority, and the Primary Care Trust) in a locality could collaborate in the delivery of public sector services. The Total Place offering would be supported by a single property management strategy across all public sector bodies thereby yielding significant property cost savings and identifying surplus property assets.

The Coalition Government looks favourably on Total Place, but will look to develop it further with the introduction of place-based area budgets or community budgets. These initiatives were discussed in a recent speech Eric Pickles gave to the Local Government Assoc, in which he insisted there was strong support for the concepts, which go beyond the Total Place initiative. He was quoted as saying "[Total Place] was like loosening the leash a tiny bit rather than simply letting local government off it. It was a bit like local government was a 15 year-old girl with really strict parents. They let you go down the dance for the first time. But then totally cramped your style by parking round the corner to watch what you were up to and made you go home at half past nine. Not so much Total Place as 'know your place.'" See *http://localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=3218%3Apickles-promises-general-power-in-localism-bill-criticises-councils-for-lacking-ambition&catid=59%3Agovernance-a-risk-articles&q=&Itemid=27* [Accessed September 29, 2010].

- Local authorities reviewing land holdings in an effort to secure “more for less”. Many public sector bodies have insufficient information about their property holdings to allow them to accurately assess land available for potential development. Those local authorities should critically review their land holdings to identify:
  - *Core operational land and property holdings*. The review should encompass the future service delivery requirements of the authority and changing workstyle patterns, ensuring that the operational assets are matched with the delivery and workstyle requirements. The purpose of the review is to identify the core operational estate to satisfy short and medium term requirements. The remaining operational property should be designated as surplus property.
  - *Core investment property*. Considerations should include whether the property is being managed for optimal return, and the longer-term merits of holding each investment property. Any property not considered a core investment property should be designated as surplus property.

Surplus property, land which is no longer used for operational requirements and has no long-term place in the investment portfolio, may well have potential for housing development. Large housing development sites will be obvious, but there are often smaller development sites to be found on waste land, around garage blocks, in low density areas, car parking areas etc, which are capable of sustaining small numbers of new homes.

Once these reviews have been undertaken, consideration should be given as to how value can be realised from both the surplus asset portfolio and the housing development sites. Sale is one possible option (either individual sites or portfolio sales). An equally viable alternative is to apply the surplus public sector land assets to balancing the development equation by using them to either secure bank finance or making them available by way of joint venture arrangements to the private sector or other public sector partners. This is developed in more detail later in the paper.

Finance

There are a number of major infrastructure and development projects under contemplation in the United Kingdom, which are unviable from a funding perspective, but which are economically justified and would potentially generate significant levels of incremental tax revenues to HM Treasury. In the current economic climate, public sector funding is simply not going to be available to subsidise those projects. We therefore need to take a fresh look at how we finance these projects and consider alternative funding mechanisms.

One such mechanism is tax increment financing (“TIF”), and this section considers the potential role of TIF in some detail. It also considers three new schemes under consideration by the Government, the Business Increase Bonus, the New Homes Bonus, and the Regional Growth Fund. Finally, the role of joint ventures in leveraging private finance using small pools of public sector funding is also reviewed.

Tax Increment Financing

TIF is essentially a means of financing the enabling infrastructure required for new development by capturing projected future, incremental tax revenues generated by the infrastructure investment.

It has been used extensively in the United States for more than 50 years, often to finance public improvements for the purpose of stimulating economic development.

By way of example, when a public investment, such as a road or a car park is built, there are two effects. The first is that new development can potentially take place (perhaps because a road has opened up access to a new site), and the second is that surrounding properties see an uplift in value (perhaps because they are refurbished or because access to their site is improved too, or simply through the regeneration effect as the area is developed and refurbished).

A TIF scheme would seek to ring-fence the resultant projected increase in property tax revenues arising from these value uplifts and apply those revenues to repaying the borrowings needed to fund the enabling road or car-parking infrastructure.

The key principle behind TIF is the "But For" principle: but for the investment in infrastructure, the resultant tax revenues would not have been generated. Most importantly (and unlike any of the developer contribution models which have been evaluated to date), there is no additional burden of tax on the developer or the occupier.

The United States has a very different system of property taxation to the United Kingdom, which will mean that the US TIF methodology would require a degree of adaptation before it could be implemented in the United Kingdom. In the United States, property taxes are collected locally and retained at the State level, and thus it is relatively simple for the State to designate TIF districts. In the United Kingdom, our principal property taxes are business rates (the National Non-Domestic Rate) and council tax. These operate as follows:

- *The National Non-Domestic Rate (NNDR)* is collected by the local authority and remitted to Government, where it is combined with the NNDR from other authorities. It is then redistributed back to the local authorities as part of the annual formula grant settlement, where it is pooled with the council tax, rate support grant and other income sources to fund locally provided services. Importantly, there is no direct linkage between the amount of NNDR collected by the local authority and what it receives back from the Government, nor is there any linkage between the NNDR collected and the incremental services that the local authority and the precepting authorities (police, fire etc) have to deliver in support of the new commercial development.
- *Council Tax* on the other hand is levied and collected by local authorities, which use it to fund schools, police, fire, rubbish collection, etc. Unlike the NNDR, there is a direct linkage between council tax collected and services provided. Thus the more new homes that are built in a local authority area, the greater the council tax collected from which local authorities have to fund local services.

Discussions on the implementation of TIF in the United Kingdom have largely focused on the use of NNDR. As the NNDR is paid over to Central Government, HM Treasury and the Department for Communities and Local Government would both need to be supportive of TIF for it to be introduced.

There has been a great deal of debate over whether enabling legislation is required to implement TIF in England and Wales, and if so, the form of that legislation. The emerging consensus is that primary legislation is required, which could take 12–18 months to implement.

The situation is slightly different in Scotland, where the NNDR is a devolved matter. The prevailing view north of the border is that TIF could be introduced in Scotland without the need for enabling primary legislation. As a result, there are now four TIF schemes being developed in Scotland, of which the Phase 2 development of the Buchanan Galleries in Glasgow, a Land Securities asset, is the most advanced.

The Minister of State for Local Government in the previous Government, John Healey, was supportive of calls for the introduction of TIF. There was a positive reference to TIF in the 2009 budget, which was followed by a letter from Healey to all local authority chief executives in May 2009 inviting local authorities to submit details of possible projects. In all, more than 100 possible TIF schemes were submitted by more than 80 local authorities, which were then reviewed by a combined CLG/HMT team.

From this list of schemes, it is thought that a small number of projects, probably no more than 5 or 6, one of which was the extension of the Northern Line in connection with the Nine Elms Opportunity Area in South London, were worked into full case studies.

The case studies were followed by an announcement in the March 2010 budget that the Chancellor would invest £120 million in support of TIF projects that deliver key infrastructure and commercial development to unlock growth. The investment would be made to enable the Government to understand the case for introducing TIF and in particular, to assess the impact of these types of investment on business rate growth. This investment has not taken place and is presumed to be a casualty of the change of Government.

Opposition to TIF has focused on four main areas:

- **Are the tax revenues generated by the TIF scheme genuinely incremental?**

  Opponents of TIF argue they merely transfer economic benefit from one area to another (the "displacement" issue). For example, can a new retail development really stimulate new retail activity, or does it merely suck-in trade from other surrounding retail developments? Should displacement be considered on a local, regional or national issue? At what point does displacement become a political decision?
  Displacement and the need to prove additionality are difficult but not irresolvable issues, and methodologies are being worked up in connection with the Scottish TIFs and some of the English case studies which address the issue effectively. Those methodologies in part consider whether TIF delivers either a greater level of economic outputs (as measured for example, in the number of new jobs created or Gross Value Added) than would otherwise be the case, and whether the delivery of those outputs is significantly accelerated by the TIF.

- **Will HM Treasury agree to effectively hypothecate the NNDR to individual TIF schemes?**

  Hypothecation refers to the dedication (or ring fencing) of the revenues raised by a specific tax to a specific expenditure purpose. The Government has generally been opposed to the idea of hypothecation on the basis that decisions on revenue raising and spending should be kept separate. Whilst there are some "charges" that are effectively hypothecated (the Television Licence and the London Congestion Charge are good examples), there are few (if any) hypothecated taxes in the United Kingdom.

- **Should public sector borrowings be used to fund TIF schemes?**

  Many of the TIF schemes proposed to date will require the sponsoring local authority to borrow prudentially to finance the upfront infrastructure costs. There is an argument that this debt only adds to the national public sector borrowing requirement and may therefore not be appropriate at this time of spending restraint. The response to this argument is similar to the additionality issue. It should be for local authority sponsors of TIF schemes (and their developer partners) to make the case for the borrowings on the basis of the economic impact the TIF scheme will have at a local, regional and national level. The two case studies below are good examples.

- **Do the risks of TIF outweigh the likely benefits?**

  Ultimately, the TIF scheme will only work if there is a means of generating sufficient NNDR to repay the initial borrowings. This will involve a careful analysis of the likely end users of new development and the ultimate ownership of the completed assets. Risk management strategies have been developed in connection with the Scottish TIFs and the English case studies, which do just this and then seek to derisk the public sector's position.

Other than the hypothecation issue, which is an issue of principle for the Government, these points can be addressed. They need to be looked at on a case-by-case basis (TIF will not be suitable for all development schemes) and the risks of each TIF scheme should be weighed up against the economic benefits delivered by the scheme.

TIF could play an important role in the country's economic recovery as the case studies below indicate. For this reason alone, an answer on TIF is needed urgently, as the enabling legislation required for the introduction of TIF will mean that the earliest TIF schemes in England could be set-up is late 2012.

Case Study 1—The Port of Dover[17]

The Port of Dover is an international gateway for freight and passengers. It is the largest passenger ferry port in Northern Europe. The Port employs approximately 5,000 people directly and supports a further 22,000 jobs indirectly. The total estimated benefit from the Port of Dover to the economy exceeds £500 million annually.

Freight movements through the port are due to double within the next 25 years, and significant infrastructure improvements to both the port (including the building of a new terminal with four additional berths) and the road network are required to service this increased traffic. These works will form part of a wider series of associated developments including two linked town centre schemes and a further three edge/out-of-town schemes.

It is conservatively estimated that the new terminal building alone will produce an incremental business rate of some £1.2 million annually which could be invested to fund infrastructure provision in connection with the linked developments, and thereby leverage significant private sector investment into the area. The return in terms of jobs created makes this a very worthwhile project—once built, the new terminal will support more than 2,400 new jobs and the linked developments will create more than 4,000 local jobs.

Case Study 2—Ebbsfleet, Kent[18]

Ebbsfleet is one of four transformational projects identified in the Thames Gateway, which incorporates the new Ebbsfleet International station. A 418 acre former chalk quarry, there are plans to build 550,000 sq m of new offices, more than 275,000 sq m of new retail, leisure and community space and some 10,000 new homes. Once complete, the site will support approximately 24,000 new jobs.

On completion, the site will produce an annual incremental business rate of some £25 million, and thus the public infrastructure costs associated with the development could potentially be fully recouped by the incremental NNDR within a twenty year period. The return on this investment would be an annual £300 million contribution to the local economy by 2026.

A blue print for introducing TIF in the United Kingdom, is suggested below:

[17] *The Port of Dover—TIF Pilot Project Submission*, (June 2009) Kent CC/CB Richard Ellis.
[18] *Ebbsfleet—TIF Pilot Project Submission*, (June 2009) Kent CC/CB Richard Ellis.

- Ring-fence a proportion of NNDR for TIF. In 2008/9, some £20 billion of NNDR was collected across England.[19] Ring-fencing 1 per cent of that amount would provide an annual fund of £200 million for TIF-based schemes.
- Local authorities and developers should be invited to jointly submit TIF proposals for that ring-fenced pool of NNDR. A clear and transparent methodology should be devised for comparing and rating those proposals. Proposals should address, inter alia:
  - The economic benefits to be delivered by the TIF scheme at a local, regional and national level;
  - How additionality is created and measures that will be taken to avoid displacement of activity to the new development;
  - The environmental benefits to be delivered by the TIF;
  - The associated tax revenues (VAT, income taxes, corporation taxes, council tax, stamp duty etc) which will be generated by the TIF scheme;
  - Certainty of delivery (how advanced is the scheme); and
  - Risk mitigation strategies (what percentage of the modelled increment will the scheme require, how could the period of the TIF be extended if needed, how is the risk/reward shared between the developer and the local authority etc).
- Restrict TIF zones in their early stages to those assets that are going to be built or refurbished as a result of the TIF (rather than extending them to include other assets which might see an uplift in their values as a result of the regeneration effect). This will allow Government to assess the impact that TIF has on adjoining property values in a more considered manner before potentially widening the boundary of any TIF district.

Business increase bonus ("BIB")

The new Government has been largely silent on their attitude to TIF since taking office, despite considerable lobbying from the property industry and many local authorities. However, in February 2009, the Conservatives published a Policy Green Paper, entitled "Control Shift—Returning Power to Local Communities". Contained within that paper was an incentive to local authorities to promote commercial development. The incentive was entitled the Business Increase Bonus, and has since been nick-named the "Tories' TIF". In short:

> "any council, in whose area the amount of business rates in a given year rises by more than the indexed rise in the national business rate, will be entitled to keep the difference for six years."[20]

This incentive has merits, and whilst it falls some way short of the TIF sought by the development sector, it could prove to be a powerful tool in the promotion of new commercial development. There are however a number of issues which need to be resolved prior to the introduction of BIB. These include:

- It is limited to only six years, whilst many of the TIF schemes modelled to date will require the NNDR to be available for 10 years or more. There may be scope to negotiate the length of the BIB term with the Government prior to its introduction;
- The BIB will operate across the local authority level, rather than being scheme specific, and may therefore be cumbersome to operate;
- It is unclear whether the whole of the BIB will be made available to the collecting authority or whether it will need to be distributed and dispersed across other precepting authorities, in which case its impact could be diluted;

[19] *Statistical Release: NNDR collected by local authorities in England 2008–9*, CLG.
[20] *Control Shift: Returning Power to Local Communities, Policy Green Paper No. 9*, February 2009.

- It is unclear whether local authorities and developers will be able to secure borrowings against these amounts, and thus whether it can be used to repay borrowings incurred to finance up-front infrastructure costs; and
- To maintain fiscal neutrality, there will be a ceiling on what is payable to local authorities.

It seems likely that the Business Increase Bonus will be implemented early in 2012 (it would be good to see it in place earlier). In the meantime, the property industry should look to work with Government to help shape this incentive, so it has a meaningful impact on our ability to deliver development, whilst not losing sight of the arguments in favour of the subsequent or parallel introduction of TIF.

Once the exact form of the BIB proposals is known, local authorities and developers should look at priority development schemes to assess whether the proposals will facilitate the delivery of those schemes on the assumption that all or part of the Business Increase Bonus is invested in appropriate enabling and supporting infrastructure.

New homes bonus

Whilst the Business Increase Bonus focused on new commercial development, the Minister for Housing and Local Government announced the introduction of a matching New Homes Bonus earlier this month to incentivise local authorities to build new homes. The New Homes Bonus will see Government matching council tax raised by local authorities on each new home for a period of six years. The Minister is proposing to leave how the matched council tax is spent to the discretion of the collecting authorities, but he specifically mentioned using it to:

- Subsidise council tax discounts;
- Boost the delivery of frontline services; and
- Improve local facilities.

The average council tax per dwelling in England is around £1,175 per annum,[21] which would equate to a total average matching payment of some £10,000 per new home over the six years. For a development of say 100 new homes, the total payment might be in the order of £1 million. The consultation on these proposals is due to complete in September and as with the BIB, once the final form of these proposals is known, developers and local authority partners should be looking at how the New Homes Bonus might be used to best effect in support of new homes delivery.

Regional growth fund

There is a further source of seed funding, which the property industry should be looking to local authority partners to develop. Earlier this summer, the Deputy Prime Minister announced the setting-up of the £1 billion Regional Growth Fund. The fund will have a dual objective:

- To encourage private sector enterprise by providing support for projects with significant potential for economic growth and create additional sustainable private sector employment; and
- To support particular areas and communities that are currently dependent on the public sector make the transition to sustainable private sector led growth and prosperity.

[21] *Council tax levels set by local authorities in 2009–10*, (March 2009) CLG.

The fund will be spread over the years 2011–12 and 2012–13, and local authorities will be expected to bid for money from the fund. Bids will need to demonstrate how they support sub-national growth, and a wide range of possible uses have been identified for the fund, including investment in infrastructure, housing, low carbon and environmental projects.

Bids will need to demonstrate that:

> "…the proposal fits with the economic priorities of the area as a whole, where possible linking to a wider economic vision which has private sector commitment and support from the community. The most successful bids are likely to include a range of projects submitted as a package that will lead to transformation for the area, providing confidence for all investors. Projects should set out how they will integrate with local planning policies, where appropriate, and any potential links with national infrastructure investment."[22]

The setting-up of the Regional Growth Fund provides the opportunity for developers and local authorities to collaborate in the submission of bids which for those key projects with a significant effect on economic growth and worklessness, will help rebalance the development equation and tip the project towards viability.

The future role of joint venture agreements

Much has been made in this paper of the need to work in partnership with local authorities and Government. This joint working can be achieved through informal working arrangements or formalised through legally-binding joint venture arrangements. This section focuses on joint ventures between developers and public sector bodies.

Joint ventures have been a feature of the property market for many years. Most recently, attention has focused on Local Authority Backed Vehicles ("LABVs"), which were based on the model adopted for the public/private joint ventures established by some of the RDAs (such as the East Midlands Development Agency's Blueprint). Only a handful of LABVs were ever set up, and with varying degrees of success.

Future joint ventures will come in all shapes and sizes. They will be used for asset management purposes, for outsourcing, for facilities management, for financing, to support economic development, for development purposes. They are the means by which many of the public income streams (including TIF) discussed above are likely to be applied to major development activity.

Future joint ventures will be about crossing boundaries. They will work across:

- Local authority boundaries,
- Public sector bodies,
- Public sector funding streams, and
- The public and private sectors.

The benefits of crossing these boundaries are clear. These joint ventures will achieve:

- Greater critical mass,
- Economies of scale,
- Sharing of risk and reward,
- Sharing of scarce resources and best practice, and
- The creation of value.

For successful joint ventures to be delivered, these models are going to require:

- Strong political leadership (at both member and officer level);

[22] *Consultation on the Regional Growth Fund*, (July 2010) BIS/CLG/HMT.

- A new type of relationship between parties to the joint venture founded on mutual trust, a shared vision and an open book approach;
- A greater understanding of how risk and reward is shared (and mitigated) between partners to the venture; and
- A longer-term horizon. Many of the joint venture models under contemplation need to transcend two or more political cycles and bind future administrations for real value to be created.

Local authorities already have many of the powers needed for the creation of joint ventures. What is now needed are some good precedents which can be replicated more widely. The case study below is one such example.

Case Study 3—The North West Evergreen Fund

> "This is proof that when left to get on with it, local areas will and do work together for the common good. This is a great example of the innovation that can be unleashed when councils and business join forces. I want to see more of this: more civil entrepreneurship, more working across old boundaries and above all, more creative use by the public sector of scarce resources." Eric Pickles[23]

In 2009, the North West Development Agency ("NWDA") designated £50 million of its European Regional Development Fund ("ERDF") allocation as JESSICA funding ("Joint European Support for Sustainable Investment in City Areas"). Monies advanced under the terms of the United Kingdom's ERDF programme, which is administered by the Regional Development Agencies on behalf of the Department of Communities and Local Government, are effectively invested by way of grant and as such are non-repayable (but subject to clawback under some circumstances). Funds invested under the JESSICA scheme are invested by way of debt, equity or guarantee, and are therefore repayable, to be recycled for reinvestment in future projects.

The NWDA split the £50m into two separate pools: £30 million was designated for investment in Merseyside strategic sites and £20 million (together with a further £10 million single programme funding) was designated for investment in strategic sites in the rest of the North West ('RONW'), namely Greater Manchester, Cheshire, Cumbria and Lancashire. Bids were invited from suitably qualified parties to establish two separate funds to manage these pools.

The winning bid for the RONW pool was a consortium comprising Manchester City Council, CB Richard Ellis and Greater Manchester Pension Fund. The bid had a number of unique features:

- The Fund is a highly innovative public sector-led joint venture, in partnership with a private sector fund manager (CB Richard Ellis), which was unique in achieving high levels of local support and consensus. All ten Greater Manchester local authorities and authorities in Cheshire, Cumbria and Lancashire are expected to become partners in the fund. More than 40 letters supporting the proposals were received from public sector partners and private sector developers prior to the submission of the bid to the NWDA.
- The fund proposals are highly ambitious. The partners' long-term ambition is to establish a major fund, professionally managed on an arms' length basis, with a track record which makes it an attractive home for institutional equity.
- Local authority pension fund investment has been secured. Greater Manchester and Lancashire County Pension Funds, recognising the pipeline of good quality investment opportunities the fund is likely to source, have both made significant allocations to the fund.

[23] *The North West Evergreen Fund press release*, (July 2010) Manchester City Council/CB Richard Ellis.

- Public/private leverage is exceptional. The involvement of Barclays Bank (providing senior debt facilities) and the two local authority pension funds will create a fund with a financial capability of in excess of £300 million. This leverages a modest £30 million of ERDF funding by a factor of ten.
- Local authority assets will be used in the fund. The local authority partners will initially be using their land and property assets to provide the matched funding necessary to secure the JESSICA funding.

Can we afford to resist change?

In the current financial and economic climate, the status quo is no longer an option. If we are to continue to develop new space, invest in infrastructure and provide new homes, change is essential. We are at a point where "regeneration" in its narrowest sense of using public subsidy in areas of market failure, is becoming a luxury in the new austerity times and may well drop from the lexicon altogether. Many of our tried and tested delivery strategies have not withstood the challenges of the recession. Dissatisfaction is high and pressure for change is mounting on all sides.

The Government has laid out a vision, localism, the implementation of which is going to necessitate a major restructuring of the local governance framework and finances. This restructuring provides the opportunity for the property industry to take a fresh look at the way in which it delivers and interfaces with the public sector.

Our industry needs to lead by example, take the initiative and respond to the Government's challenge to innovate and to deliver "more for less". It needs to play its part not just in responding to the public spending cuts, but in targeting investment to projects which contribute to economic growth. However, the property industry cannot act on its own. Most major developments require the involvement of both the public and private sector. Developers needs a stable and consistent partnership with Government (in all its many forms), where kneejerk policies are avoided, where there is appropriate consultation and debate on change, and a genuine and serious consideration of the issues facing the industry. There needs to be a degree of active listening by ministers and civil servants in Downing Street, in the Treasury, in BIS, and within the Communities and Local Government team, with a fair and transparent evaluation of proposals put forward by the property community. In return, the property community should look to support the Government as it seeks to reduce the deficit and stimulate economic growth by innovating, by looking to deliver more for less, and by responding positively and honestly to new opportunities. A number of first concrete steps have been outlined in this paper. Now is the time for the property sector collectively, supported by our various industry bodies, to propose other first steps, and to frame new delivery mechanisms around a shared vision.

The combination of D, V and F is compelling. Resistance is futile.