Innovative financing instruments for real estate development in Western Europe
Report available from:

www.rics.org/uk/knowledge/research/research-reports/innovative-finance-in-pan-european-regeneration/
Rationale

• In the new era following the 2007-08 Global Financial Crisis (GFC), the financing of real estate development in regeneration areas across Europe has evolved to take into account the realities of the new economic environment (e.g. budgets and capital constraints)

• What innovative financial instruments that have emerged, if any?
Focus: Aims and Objectives

- Since the 2007-08 Global Financial Crisis (GFC), financial instruments have become more innovative across Europe when used in real estate development for regeneration.

1. Critical review and analysis of innovative financial instruments for real estate development within a regeneration context across Europe
2. Insights at project level from specific case studies in the UK, Germany and the Netherlands to capture contemporary innovations in finance
3. Discuss any new finance approaches that could be seen as ‘innovative’
Methods – Desk Based Study and Semi-Structured Interviews

- RICS UK and Brussels
- Composition Capital Partners
- Buildings Performance Institute Europe (BPIE)
- Consilia Capital
- AEDES Dutch Association of Social Housing Organisations
- CECODHAS Housing Europe
- Battersea Power Station Development Company Ltd
- Delft University
- The Commercial Real Estate Finance Council Europe (CREFC Europe)
- Royal Bank of Canada
- Fédération de l'Industrie Européenne de la Construction (FIEC)
- University of Regensberg
- British Property Federation (BPF)
- European Association for Investors in Non-Listed Real Estate Vehicles (INREV)
- University of Aberdeen
- LaSalle Investment Management
- European Investment Bank (EIB)
- AMP Capital
- Winchester Partners
- Leipziger Platz Development, Berlin
- Malmendier Hellriegel Rechtsanwälte Partnerschaft
Innovative Finance: In General

• The European Union (EU) defines innovative financing of real estate development as the use of loans, guarantees, equity or quasi-equity investment, or other risk-bearing tools – that can be combined with grants and involve risk-sharing with financial institutions to boost investment in large projects (Spence et al., 2012).
Literature Review Key Themes

• Economic Rationale = **Spatial Uneven** European Consequences of GFC (by City/Regions/Country)
• Finance Mix and Design = **Blending** of loans and grants
• Land Ownership, Governance, and Planning = Public sector as **enablers and allocators** of finance
Literature Review Key Themes

• Sector Preference, Asset Class, Risk, and Return = **Mixed Use** Development (including Residential); typically **high risk with low returns** - but potential to increase **sector diversification** and **enhance long-term returns**
• Partnerships, Legal Issues and Procurement =
  – **PPP** and **Risk Sharing**;
  – **Joint Finance** by PFI, joint ventures, outsourcing and equity stakes;
  – **Land ownership rights** as part of the finance mix;
  – Large scale of projects; **partnership** advantages in reducing procurement costs
Literature Review Key Themes

- Policy Drivers, Barriers and Opportunities
  - Financial leverage from mayors, planning departments and entrepreneurial local authorities
  - E.g. Municipality funding the necessary infrastructure and decontamination
  - ‘Positive Planning’ policy
Analysis - **10 Key Components of Finance Constraints** in Pan-European Real Estate Development for Regeneration

<table>
<thead>
<tr>
<th>Component</th>
<th>Factors</th>
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<tbody>
<tr>
<td>1. Economic and Political Conditions</td>
<td>Austerity; Grant Reduction; Credit Restriction; Demand for property; Value-for-money; Efficiency; Political Cycle; Political expediency; Reduce market failure; Desire for Regeneration and Redevelopment; Sector and tenure shift; Increased Cohesion; Greater Equity and fairness; Environmental pressure; Desire for Sustainable development</td>
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<td>2. Government Policy and Governance Scales</td>
<td>Local, Regional, National, Supra-National; Central-Periphery; Agency-Structure; Elites; Stakeholders; Public Incentives; Partnerships</td>
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<td>3. Land Acquisition</td>
<td>Government; Public bodies; Developers; Land banks; Compulsory Purchase</td>
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<td>4. Legal Rights</td>
<td>Compulsory Purchase Orders, Legal Territory</td>
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## Analysis - 10 Key Components of Finance Constraints in Pan-European Real Estate Development for Regeneration

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<tr>
<td>5. Fiscal, Regulatory and Monetary Instruments</td>
<td>Grant; Value Capture; Debt-Equity; Loans; Bonds; Fees; Taxation; Investment Funds; Blended Finance; Co-financing; Re-parcelling; Institutional Investment Funds; Exactions; Contributions; Agreements; Levies; District and Zoning; Guarantees</td>
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<td>6. Planning</td>
<td>Prescriptive Rules; Negotiated Finance; Master-plan; Strategy; Community participation</td>
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<td>7. Construction Cost Inflation</td>
<td>Material Prices; Development Costs –Land, Labour, Capital, Entrepreneurs; Procurement Cost; Cost of Finance</td>
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<td>8. Time and Phases of Development</td>
<td>Project Stalling; Defaults; Long Period Multiple Phases</td>
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<td>9. Scale of Development</td>
<td>Large scale –Cumbersome; Small scale – Weak; Complex; Multiple Owners</td>
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<td>10. Level of Developer Risk-Return</td>
<td>Profit Return; Ownership; Capital; Cash Flow; Revenue; Yield; Risk intensive</td>
</tr>
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Analysis - 4 principal components of the development continuum

1. Development **conditions**
   – Such as allowing EU national grants blending with EIB (European Investment Bank) loan products

2. Development **instruments**
   – Such as institutional, Debt-Equity, FDI (Foreign Direct Investment), Bonds and Exactions

3. Development **guidance**
   – Such as good governance and strategic vision: planning-led

4. Development **process**
   – Such as full awareness of cost, time, scale, risk and return
Case Study Findings – Battersea, London, UK
Case Study Findings – Battersea, London, UK

- A mixed-use residential and commercial scheme
- Includes **debt-equity financing** sourced from Malaysian FDI and pension funds, along with international banks
- Integral to the success of the project is the **transport infrastructure** and the partnership approach with the **public sector** (Tube extension / £1 Bn Loan Board)
- Funding to repay the infrastructure **loan is dependent** on the commercial space generating **business rates income**.
Case Study Findings – Leipziger Platz, Berlin, Germany
Case Study Findings – Leipziger Platz, Berlin, Germany

• A mixed–use commercial and residential development
• **Debt-equity** financing, with **land assembly financed** primarily from a number of institutional investors – one of the biggest financial deals in Germany following the GFC
• Success in largely pre-rental agreements
• **No municipal authority** involvement in the partnership or financing arrangements
Case Study Findings
– Lammenschans, Leiden, The Netherlands

Case Study Findings
– Lammenschans, Leiden, The Netherlands

• Mixed-use scheme notable for its **fragmented landownership**
• Used legal-financial instrument ‘**urban land readjustment finance**’
• **Subdivided parcels** by the municipality; developed by private developers and landowners; with **some** land use planning **restriction**; exchange of **ownership rights**
• Towards **passive** municipal land development **strategies**
Case Study Comparative Analysis – How does innovation compare?

**Similar Trends**
- Growth in the *blend* of financial products
- Greater focus on *equity financing* given the constraints applied to *debt financing*
- Equity financing in the form of *institutional funds* both *domestically* and from *foreign consortiums*
- *Partnership* structures to generate financing; a *collaborative-competitive ethos*
- Beginning to utilise a mix of *large-scale multi-bank finance*
Discussion: Windows of Opportunity in Different Timescales - Project Finance Bonds

- **Gilt yields** are at their lowest level for 30 years – low return
- Opportunity to satisfy investment demand for long term (higher yielding) income products by introducing some form of infrastructure or development bond
- **Window may close** in the event of interest rate rises (not so immediate at wider European scale)
Discussion: Windows of Opportunity in Different Timescales - Project Finance Bonds

• Institutional investors are attracted to bonds due to the matching of long-term debt to long-term cash flows of the project
• Appeal at a time when the tightening of the regulatory regime following Basle III and Solvency II has resulted in higher solvency levels and less lending in the market
• European Investment Bank (EIB) is committed to supporting project bonds through its Project Bond Credit Enhancement Initiative.
Conclusions and Recommendations

1. Securing **blended and diverse** sources of finance for real estate development is key to aiding regeneration
2. Projects need to be set within a **collaborative-competitive partnerships** framework
3. Consider the **wider macroeconomic considerations** such as interest rates and how that will affect various funding sources over the **longer-term**
Conclusions and Recommendations

4. Opportunity to expand the use of **infrastructure and project bonds** into real estate development and regeneration

5. **Wider critique** – such as the greater **pre-sale** real estate revenue, **foreign institutional finance**, and **legal co-operative finance** in re-parcelling sites

6. Consider the financial innovations emerging from **equity (rather than debt)** and the use of **institutional funds**
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The Team

Dr Graham Squires, University of Birmingham
g.squires@bham.ac.uk

Professor Norman Hutchison, University of Aberdeen
n.e.hutch@abdn.ac.uk

Professor Jim Berry, University of Ulster
jn.berry@ulster.ac.uk

Professor Alastair Adair, University of Ulster
as.adair@ulster.ac.uk

Professor Stanley McGreal, University of Ulster
ws.mcgreal@ulster.ac.uk

Samantha Organ, The University of the West of England, Bristol
Samantha2.Organ@uwe.ac.uk
THANK YOU.