Innovative financing instruments for real estate development in Western Europe

UNIVERSITY OF BIRMINGHAM

Ulster University

UWE BRISTOL University of the West of England

1495 UNIVERSITY OF ABERDEEN

Report available from:

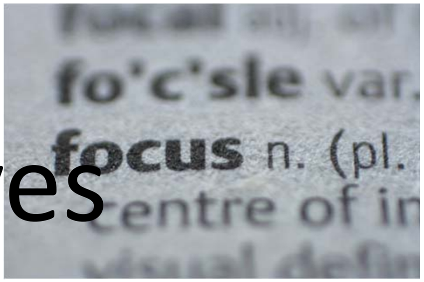
www.rics.org/uk/knowledge/research/research-reports/innovative-finance-in-pan-european-regeneration/

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

Literature Review Key Themes

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

Component	Factors
1. Economic and Political Conditions	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
2. Government Policy and Governance Scales	Local, Regional, National, Supra-National; Central-Periphery; Agency-Structure; Elites; Stakeholders; Public Incentives; Partnerships
3. Land Acquisition	Government; Public bodies; Developers; Land banks; Compulsory Purchase
4. Legal Rights	Compulsory Purchase Orders, Legal Territory

Analysis - **10 Key Components** of **Finance Constraints** in Pan-European Real Estate Development for Regeneration

Component	Factors
5. Fiscal, Regulatory and Monetary Instruments	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
6. Planning	Prescriptive Rules; Negotiated Finance; Master-plan; Strategy; Community participation
7. Construction Cost Inflation	Material Prices; Development Costs –Land, Labour, Capital, Entrepreneurs; Procurement Cost; Cost of Finance
8. Time and Phases of Development	Project Stalling; Defaults; Long Period Multiple Phases
9. Scale of Development	Large scale –Cumbersome; Small scale – Weak; Complex; Multiple Owners
10. Level of Developer Risk-Return	Profit Return; Ownership; Capital; Cash Flow; Revenue; Yield; Risk intensive

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

http://www.archello.com/en/project/roc-leiden

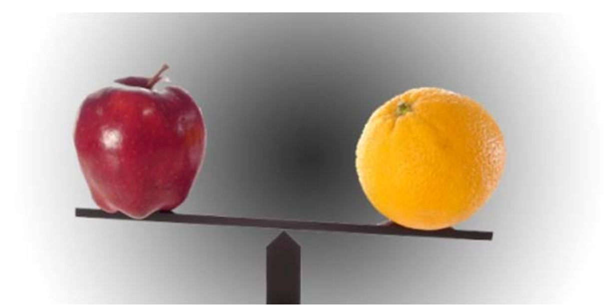
Case Study Findings
– Lammenschans, Leiden, The Netherlands

- 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**

Report available from:

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

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.