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Urban Economics and
Real Estate

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The Future Financing of Real Estate Development in Cities:
Comparing US and European Approaches

Overview

1. Squires, G. (2014). **The Future Financing of Real Estate Development in Cities**. RICS - Fulbright
2. Squires, G., Hutchison, N., Adair, A., Berry, J., McGreal, S., Organ, S. (2015). **Innovative finance for real estate development in pan-European regeneration**. RICS
3. Drawing some points of **discussion** – comparative thinking and doing

Research



September 2014

The Future Financing of Real Estate Development in Cities



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Research



February 2015

Innovative Finance for Real Estate Development in Pan-European Regeneration

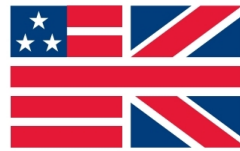


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The Future Financing of Real Estate (Residential) Development in Cities: **The Problem?**

- The **lack of adequate** basic urban services and **infrastructure** (including **Affordable Housing**) is a major challenge in the development of human settlements
- **The lack of revenues** is one of the biggest problems facing most cities all over the world
- Governments vulnerable **with increasing responsibilities and small share** in the allocation of public resources (UN Habitat, 2012)

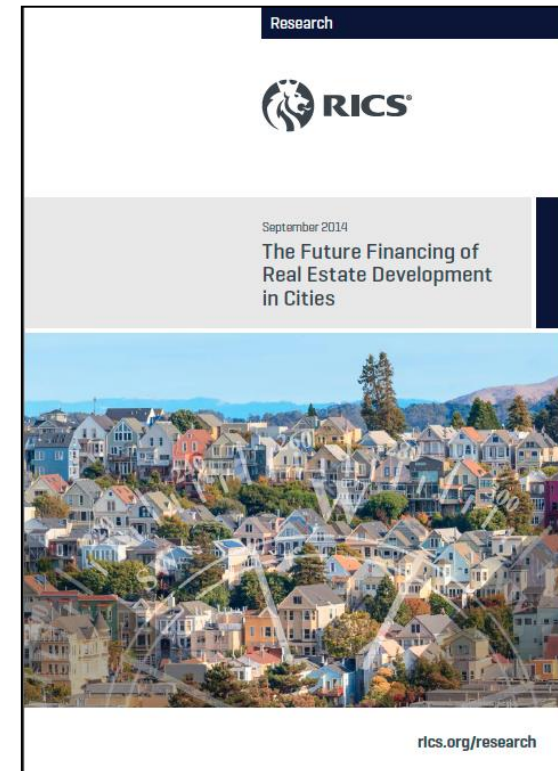


Figure 1

The Bay Area Case Study Counties, Key Cities, and Regions

- Nine [9] Counties
- One-Hundred and One [101] Cities



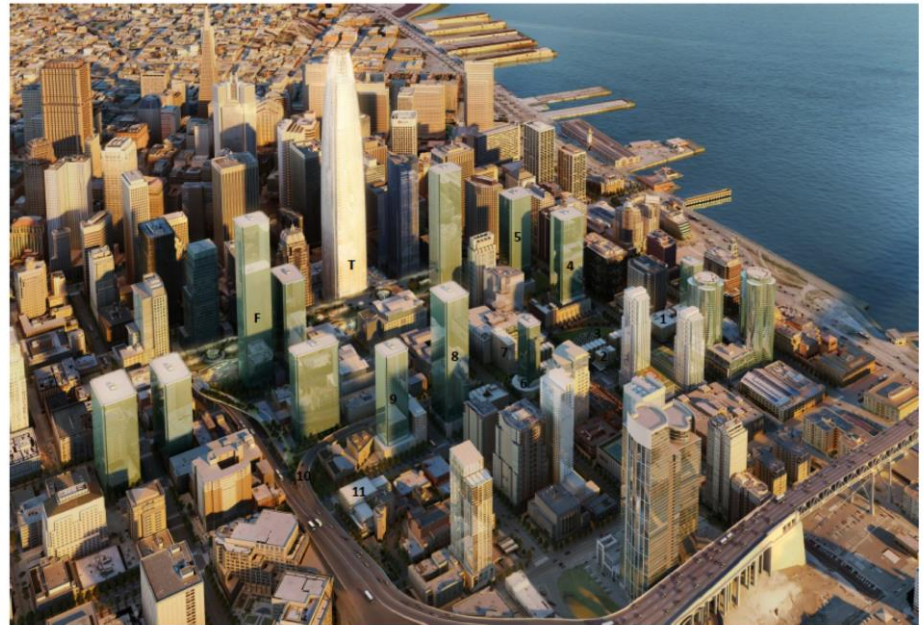
Note – The boundary between Peninsula and South Bay is not formal; some locals, and some other sites/guides may place some of the northern Santa Clara County cities categorized here as “Peninsula” as South Bay.

Source: Perry Planet (2014).

Case Study: The Bay Area

Transbay Redevelopment Project

Successor Agency to the
San Francisco Redevelopment Agency



Digital rendering showing the future Transbay neighborhood (with publicly-owned parcels labeled – see map on back) and Rincon Hill. When completed, the Transbay Redevelopment Project will add 3,000 housing units and 3 million square feet of commercial space to Downtown San Francisco, all surrounding the new state-of-the-art Transbay Transit Center. The Transbay Transit Center is currently under construction with an estimated completion date of 2017.

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Methodology: Key Institutions Interviewed

- ❑ Bay Area Economics
- ❑ Eden Housing
- ❑ Urban Land Institute (ULI)
- ❑ University of California – Berkeley
- ❑ Mayors Office – City Hall –San Francisco
- ❑ Association of Bay Area Governments (ABAG)
- ❑ Prudential
- ❑ Wells Fargo Bank
- ❑ Amcal Housing
- ❑ SPUR (San Francisco Planning and Urban Research Association)
- ❑ Bay Area Council Economics
- ❑ San Francisco Port Authority
- ❑ The US Housing Partnership Network
- ❑ TMG Partners.



Key Mechanisms – Federal Influence

- Importance of the **Community Reinvestment Act (CRA)**
 - Federal Act on Banks
 - Credit Scores

- **Low Income Housing Tax Credits (LIHTC)** for Affordable Housing Development Projects
 - For Finance and Investment
 - Trend of Recapitalising/Rehabilitating Existing Affordable Developments – Near end of LIHTC Life (20 Years)



Key Mechanisms - Bonding

1. **Tax Increment Financing (TIF)**
 - A type of **Value Capture Bonds (VCB)**
 - Principal funder of **Redevelopment Agencies (RDA)**
 - **RDA now abandoned** – California fiscal gap
2. Now operated in **Infrastructure Financing Districts (IFDs)**
 - **No blight**, TIF was for blight (renewal)
3. **Community Facilities Districts (CFDs) Bonds**
 - **Mello-Roos** Law Drives Financing of CFDs
 - Uncapped % **tax on property** to pay bond for '**community facilities**'
 - Need **Community Vote** – Incentivises Unoccupied **New Build**



Key Mechanisms

Planning Obligations and Developer Contributions - Fees, Charges, Levies, Agreements

1. Impact Fees and Agreements

- Exaction for external impact cost (with a rational nexus)
- Community Benefit Agreements (CBAs)

2. Inclusionary Zones (IZs)

- Inclusionary Housing Levies (IHL)
- Below Market Rate – 20%

3. Inclusionary Housing Fees (IHF)

- Unit Based

4. Greater City Fiscal Control

- Housing Trust Funds (HTFs)



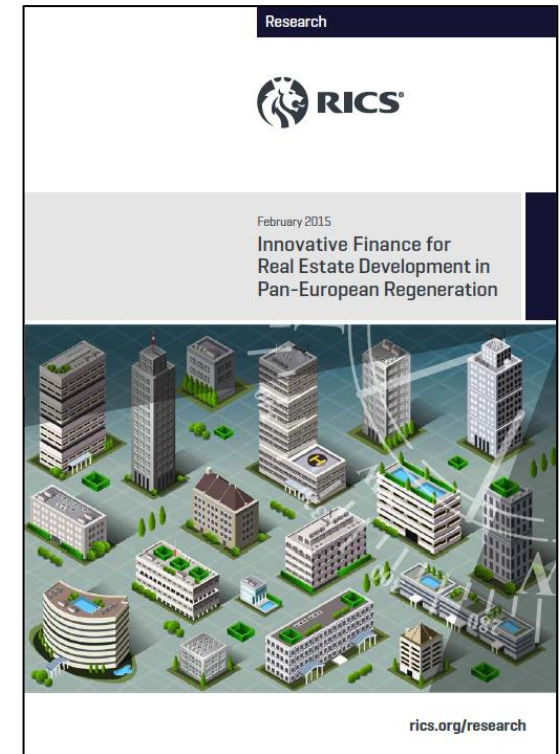
Key Mechanisms – Further Finance

- ❑ **Syndicate** Private Real Estate Loans – Joint Bank Loans/Real Estate Investment Trusts (REITs)
- ❑ Special **Property Tax (on sale)** - Prop. 13 (capped 1% per year)
- ❑ **Upzoning** – Height De-Regulation
- ❑ Transit Orientated Development (**TOD**) Funds – Priority Development Areas (**PDA**) including Affordable Housing
- ❑ **Cross-Sector:** Employment Tax Exemption for Property – (e.g. Twitter / Mid-Market).



Squires, G., Hutchison, N., Adair, A., Berry, J., McGreal, S., Organ, S. (2015). **Innovative finance for real estate development in pan-European regeneration. RICS: The Problem?**

- 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 and **innovated** to take into account the realities of **the new economic environment** (e.g. budgets and capital constraints)





Innovative Finance

- 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).

Methodology: Key Institutions Interviewed



- 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 Regensburg
- 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

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

- A **mixed-use** commercial and residential development
- **debt-equity** financing, primarily from a number of institutional investors (and bank debt) – 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 – largely **private**



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** (municipalities as passive enablers)
- Beginning to utilise a mix of **large-scale multi-bank finance**



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)



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.

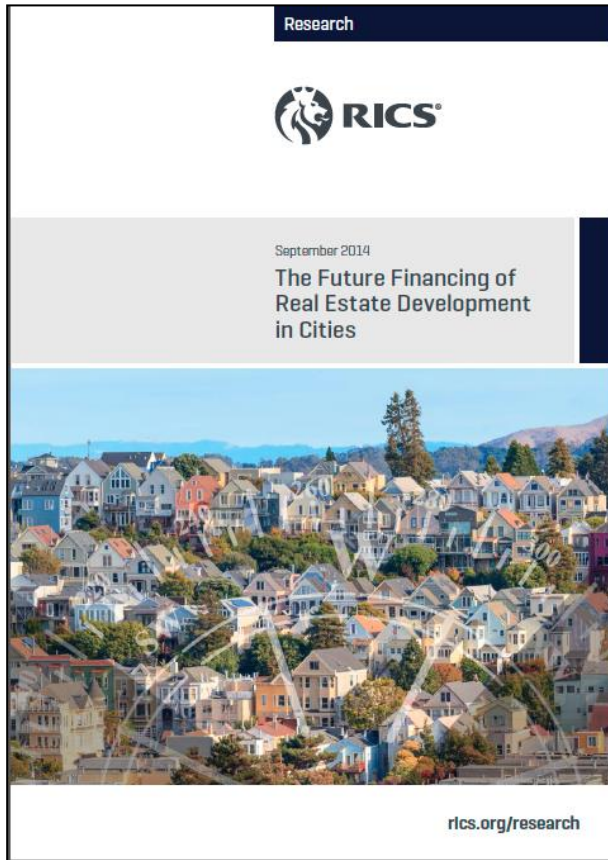


Points of Discussion

- Can we make **comparative conclusions/recommendations**
 - lesson learning & policy transfer?
- **US Points:**
 - Federal – Tax Credits; Bonding – Value Capture; Developer Contribution; Upzoning; Property and Land Tax; Cross-Sector; Transit-Oriented
- **European Points:**
 - Blended and diverse sources; Collaborative-competitive partnerships; Interest rates & Project bonds; Equity (not debt) foreign and institutional finance; Pre-sale; Regulatory value in re-parcelling; crowd-funding?

Thank You!

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