Factors affecting private investment in regeneration (Urban Research Summary No.6)
On 5th May 2006 the responsibilities of the Office of the Deputy Prime Minister (ODPM) transferred to the Department for Communities and Local Government.

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**Introduction**

This study commissioned by the Office of the Deputy Prime Minister is a review of existing evidence and lessons that emerge from previous research on the factors that influence the private sector to invest in regeneration. The active involvement of the private sector is critical to the success of regeneration. However the private sector is not a homogeneous group in terms of the diversity of interest involved, the potential roles these actors may play and the degree to which they engage in the regeneration process. The brief for this study placed emphasis upon a desk-based approach drawing primarily upon literature sources but supplemented by a selected number of interviews with key stakeholders.
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**Key Findings**

1. The role of the private sector in regeneration is to use its resources to create new or added activity that will enhance the level of economic performance and by doing so raise value, expectations and confidence within areas and provide the circumstances for further and sustained investment.

2. The primary reason why the private sector invests is the expectation of achieving above average rates of return to offset added risk. The private sector looks for growth and profit and discriminates between areas on the basis of these criteria.

3. Regeneration locations are not uniform and certain sites offer significantly greater potential in terms of either their physical attributes such as a waterfront location or financial characteristics in terms of market pricing. Indeed under-priced markets can present both developers and investors with significant opportunities.

4. There are many barriers to be overcome in regeneration areas. The private sector will not invest in regeneration areas without substantial public sector commitment. The role of the public sector is to create confidence in a regeneration area as an investment location thereby reducing the level of risk to investors. This can be achieved through various mechanisms, physical and fiscal, but increasingly attention is being focused upon more innovative financial vehicles.

5. Arising from data deficiencies there is a relative lack of transparency in regeneration areas, market signals are weak and confused thereby creating conditions of uncertainty that deters major institutional investors. The lack of information is important in perpetuating misconceptions of regeneration areas in terms of risk and levels of return.

6. The under-pricing of regeneration markets by the private sector is a symptom of the information deficit and militates against the desire to raise value. Likewise the risk premia that investors place on regeneration locations reflect stigma arising from site contamination and the perception of low environmental quality.

7. The private sector stresses the rational behaviour underpinning decision-making and the perceptions of risk within regeneration areas. However it is apparent that the means by which information is communicated to investors is not always transparent with a series of potential filters. Given that other investment opportunities are more visible, regeneration options may not even come under consideration.

8. The private sector places considerable emphasis upon the effects of crime and security considerations. These factors strongly influence image and perception of regeneration areas. Quality of product is important if institutional investors are to be attracted to regeneration locations.

9. The loss of the Partnership Investment Programme has had serious implications for the attraction of private investment with a high degree of confusion concerning successor arrangements. There is evidence of dissatisfaction concerning this issue on the part of both public and private sectors notably in relation to the detrimental impact upon the number of new schemes coming forward.

10. The key role of public bodies in regeneration is in the creation of an environment conducive to the private sector. Added-value can be obtained by cross-sector co-
operation and with the changing relationship between private and public sectors new opportunities to bring forward schemes and share short-term risk become feasible.

11. Urban Regeneration Companies are perceived favourably as potential delivery mechanisms with their particular attraction to investors being the single point of contact model.

12. A more flexible role for planning and greater consistency in regeneration and development issues is central to encouraging private investment. An effective and efficient planning system will provide greater certainty and reduce risk to the private sector.

13. Community involvement does not necessarily conflict with private sector investment interests, indeed benefits such as enhanced security can be channelled to positive effect. It is important for businesses to move into communities rather than having business and community regeneration as separate entities.

14. Amongst the key messages from the Urban Summit was the need to engage and involve the private sector much more effectively within regeneration. There is clear recognition that to move the regeneration agenda forward that the private sector needs to be playing a fuller and more central role.
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The study
The scope of the study is centred on the role of the private sector in regeneration. Eleven core questions set the terms of reference with the research seeking to address issues pertinent to the environment in which the private sector operates. In summary the questions related to:
- the type and form of private investment
- why the private sector invests in some regeneration areas and not in others
- barriers preventing private sector investment
- how long-term investment can be encouraged
- are private investors responding to market signals
- impact of quality of the environment on levels of private investment
- how can private investment be encouraged into difficult areas
- the relationship between different forms of intervention and EC State Aid rules
- what role does commitment from public bodies play in encouraging private investment
- what role can planning play in encouraging private investment
- how can sustained community involvement be encouraged.

These questions are considered in the Report under three headings namely:
- private sector perspectives
- information, image and perceptions of regeneration
- public sector support for regeneration.
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**Private sector perspectives**

Evidence from interviews strongly supports the case for regeneration where markets are perceived to operate at a lower level of efficiency. To make such locations self-sustaining there is a requirement to raise value. In this respect, the private sector needs to be convinced of the merits of investing but equally the private sector is central to the adding of value. Part of this process is the generating and raising of property values within the regeneration area. However it is important that the private sector delivers schemes, in particular, mixed-use developments that are consistent with sustainability objectives. This requires a strategic approach to investment based on mixed-use schemes rather than a single use model. Public sector agencies have an important brief to ensure that such objectives are delivered.

Studies have shown that regeneration may raise landowners’ hope value with a potential negative impact on achieving development if increased value expectations are not fulfilled. Other downside effects include the potential for regeneration to produce unequal markets/unfair competition with displacement effects.

Evidence from literature sources argues that the primary reason why the private sector invests in some regeneration areas is the perception of achieving the target rates of return. Conversely, the literature suggests that the principal reasons for non-investment in regeneration areas include the perception of bureaucratic grant regimes, negative image of neighbouring environments, lack of or low rates of capital appreciation and/or rental growth. These investment decisions are a function of the availability and quality of property, occupier demand, characteristics of labour markets, social factors, transport, regulatory and planning considerations. Furthermore, efficient and receptive markets for land and property are essential to lever investment into regeneration schemes.

Interview evidence shows that the private sector is opportunity driven, invests in areas where it is comfortable and where returns are achievable commensurate with the risk taken. The private sector looks for growth and profit and discriminates between areas on the basis of these criteria. The private sector will look for incentives to reduce its exposure to risk. In this respect grant regimes have been extensively used as tools to lever investment.

Under-priced markets exist and can present a significant investment opportunity. Regeneration sites are far from uniform, with certain locations for example waterfronts presenting significantly more favourable environments. Interview evidence confirms that the private sector will seek out such locations but frequently the public sector needs to provide the trigger. This can be in different forms. For example studies have shown that the provision of high quality infrastructure is a key element of successful regeneration with effective public transportation systems leveraging significant regeneration benefits. Integrated land use and transport planning is also essential in facilitating indigenous and inward investment.
The barriers to investment in regeneration are numerous. Various studies have identified the perception of negative returns as being a fundamental barrier. Other research highlights the constraints to site assembly imposed by multiple land-ownership. These are issues that the private sector looks to public agencies to resolve through the use of Compulsory Purchase Orders (CPO). Contaminated brownfield sites are a major disincentive; indeed developers are only likely to consider brownfield sites when publicly funded initiatives or generous tax-breaks are available. These represent further examples of where private investment will not be forthcoming in the absence of public sector action.

Interview evidence confirms that the private sector, although normally looking for the public sector to be involved in regeneration, makes frequent criticism of administrative mechanisms, agencies and funding regimes. Time delay in obtaining decisions from local authorities is a major barrier to private sector investment. Streamlining and clarity of policy and the need for cross-departmental structures so that mechanisms are hitting the same target and minimising boundary issues are seen to be essential in the delivery of regeneration.

Evidence in the literature equates long-term investment to activity by institutions which, by their nature and responsibility to their stakeholders, are risk averse and thus cautious about holding regeneration investments. To encourage long-term investment, risk reduction factors are required. Investors will seek to protect their outlay by looking for a range of alternative mechanisms including a possible guaranteed minimum return, pre-lettings, contamination remediation, and exit strategies.

The literature considers that differences between long and short-term investors relate to the nature of particular companies and businesses. Property development companies are frequently viewed as short-term investors though strategies differ between companies. The short-term investor is the initial risk-taker and through the identification of opportunities can create the potential to attract the longer-term institutional investor into regeneration. Self-sustaining schemes are equated to quality schemes, the ability to maintain occupiers on long leases and to keep the market working. The raising of land values/achievement of profitability are positive influences in achieving self-sustaining investment.
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Information, image and perceptions of regeneration

Evidence from the literature classifies urban regeneration areas as secondary/tertiary property markets which lack the level of information efficiency that characterises the prime markets. As a result investment opportunities often do not materialise due to the inadequacy of market data. Furthermore, the lack of information perpetuates negative perceptions of regeneration areas with institutional investors seeing risks as too high.

Evidence from interviews confirms that market signals regarding regeneration are likely to be weak and confused. Under these circumstances, the private sector is perceived to be acting rationally to market signals in regeneration areas in the pricing of and reaction to risk. However evidence within the literature would suggest that the private sector persistently under-prices these locations, contrary to the objective of raising value. Over-response to market signals and misconceptions have led to over-correction by the market in terms of pricing of risk. There is the potential that returns are misperceived.

Quality of the local environment is perceived as a risk factor and therefore impacts upon the level of private investment. This is supported by evidence from the literature which suggests that the quality of neighbouring environments can act as a deterrent to investment. Negative image and stigma are shown to play a significant role in discouraging investment, with impact on value. Improvements to encourage investment include contamination remediation, site clearance and site screening, environmental enhancement, infrastructure improvement and investment into public realm.

Five key messages for the Private Sector

- The need to embrace mixed-use schemes from developer and investor perspectives as part of a sustainability agenda - self-sustaining developments with active sale and letting markets deliver successful regeneration.
- The need to establish robust valuation methodologies including more explicit risk pricing of land and property.
- The need to enter into more innovative funding partnerships and develop financial instruments appropriate to regeneration areas.
- The need to facilitate improved information flow and transparency regarding investment returns within regeneration areas.
- The continuing need for businesses to develop socially responsible investment policies and engage more fully with communities.

Evidence from the literature and supported by interviews shows that image and perception can play a fundamental role in either discouraging or encouraging investment. The relationship between quality of the environment and infrastructure is fundamental to the goal of raising value without which the private sector is unlikely to participate. Connectivity of policy is vital in adding to the quality of the local environment whereas poor image can blight a location with little prospect for private investment.
There is a broad consensus from the interviews that areas adjacent to town centres that have experienced decline arising from the closure of shops and businesses and the out-movement of activities warrant further attention from a policy perspective. Many of these locations are likely to be within disadvantaged wards and hence eligible for fiscal relief measures. The literature considers how in theory these offer the dual benefit of providing regenerative effects through land and property markets and also working through businesses, though whether fiscal incentives have the ability to regenerate whole areas in the absence of other incentives is an open question. Reduction of stamp duty is seen as a means of increasing liquidity within the property market thereby reducing potential blockages and generating demand-side activity.

Evidence from the literature discusses how displacement effects are negative impacts of regeneration. These have characterised past regeneration initiatives such as short-distance transfers and local displacement effects in Enterprise Zones (EZs). The Business Improvement District (BID) concept which has been effectively used in several US cities to address problems associated with commercial areas around city centres (and has been advocated for UK cities) also suffers from displacement effects, notably the exclusion of disadvantaged social groups in particular homeless persons.
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Public sector support for regeneration

Evidence from the literature on the debate concerning the former Partnership Investment Programme (PIP) of English Partnerships has sharply focussed upon the relationship between intervention and State Aid rules. This clearly has major significance in terms of regeneration notably outside of locations with assisted area status. The Twelfth Report of the Transport, Local Government and Regions Committee considers that the loss of PIP has been significant with effects apparent on particular regeneration schemes. Their most recent report supports the Government’s policy to argue for new State Aid rules for regeneration.

Evidence from the literature considers that risk factors within regeneration areas are such that public sector commitment is required to lever private investment. The form and role that public bodies play can be diverse but of central importance is confidence-building measures in creating an environment conducive to the private sector. Emphasis on area-based regeneration has focussed on policies and a raft of initiatives to help correct the adverse impact of market forces. Commitment from public bodies has been critical to this process.

Interview evidence confirms that the relationship between private investors and the public sector has not always been harmonious. However the private sector generally is reluctant to become involved in regeneration in isolation, though examples exist of developers proceeding with schemes and backing growth in property market values rather than engaging in the process of seeking grant aid. Conduits need to be developed between institutions and public sector agencies to enhance interaction and private sector investment in regeneration. The changing relationship between private and public sectors is important in bringing forward development schemes and sharing short-term risk.

Literature and interview evidence shows that interaction is being achieved through partnership structures. However the commitment of the private sector to partnership arrangements has been questioned. Private sector actors recognise that English Partnerships and the Regional Development Agencies (RDAs) have key roles to play in the allocation of funds. Investors and businesses see the longer-term approach of Urban Regeneration Companies (URCs) and their ability to offer a single point of contact in a largely positive manner.

Five key messages for Policy Makers

- The need for public policy makers to understand the mind-set and language of private sector actors.
- The need for greater flexibility in the planning system, this is being addressed in new legislation.
- The need to use CPO powers more frequently and effectively.
- The need to promote greater data availability and data transparency from
government departments and agencies.

- The need to further develop innovative financing vehicles with the private sector, in particular institutional funds for use within and outside of assisted areas that comply with State Aid rules.

Interview evidence identifies that planning has a key role in encouraging private sector investment and promoting economic growth by delivering land for development in the right location, though interviewees consider that planning has not always adequately fulfilled this role. Furthermore, sources such as the Urban Task Force have highlighted the contribution that planning can make in facilitating urban regeneration. Clearly, planning can be used as an instrument in encouraging urban regeneration by channelling development and investment opportunities towards brownfield sites and inner city locations.

Evidence regarding the impact of the use of Section 106 agreements to secure planning gain is not so strong though proposed reforms are seeking to deliver more positive planning and sustainable development. The literature indicates a need to balance planning gain against the overall viability of the scheme particularly on brownfield sites where development costs are higher. Developers endeavour to pass costs of off-site liabilities forward to purchasers or backwards to landowners, depending on market conditions but the extent to which this is possible in regeneration locations is questionable.

Evidence from interviews shows that the extent to which planning can stimulate regeneration is dependent upon the ability to stop competing development on greenfield sites, but not restrict supply by making better use of land within existing urban areas. However developer confidence in the planning system is low with the dominant private sector perception being one of inflexible, legalistic and bureaucratic procedures. It is recognised that an effective and efficient planning system is essential in providing greater certainty and reducing the risk to the private sector.

Evidence from the literature indicates that sustained community involvement and private sector investment are not incompatible. Positive community involvement can result in increased security and enhance a greater appreciation of the commercial requirements of the private sector. Development of the skills base, a trained workforce, labour market competition and the wider involvement of the community in an operational context can bring major benefits to businesses.

Community enterprise organisations are seen as playing an important role through direct involvement but they do not offer a panacea to mainstream investment. Interview evidence stressed the importance for business to move into communities rather than seeing business and community-led regeneration as different entities. In this respect partnership between elements is important; businesses and companies need to feel that they are making a contribution to the community. Important to this process is the increasing awareness of institutions and their responsibilities in terms of socially responsible investment.
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Further Information

The full report on which this summary is based is published on the website:
www.engj.ulst.ac.uk/RPP/odpm_report.pdf

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