Urban Economics and Real Estate

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


3. Drawing some points of discussion – comparative thinking and doing
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).
Case Study: The Bay Area

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).

Transbay Redevelopment Project

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 8 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 2027.
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)s**
   - 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).
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 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
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)*
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!  
g.squires@bham.ac.uk

www.rics.org/financingcities