SOUTH EAST ENGLAND DEVELOPMENT AGENCY

BOARD MEETING ON 18 JUNE 2009

ITEM 5

BARRIERS TO DEVELOPMENT IN PROPERTY AND HOUSING

Recommendations

The Board is invited to:

- **NOTE** the impact of the recession on the property industry and the implications for the region's economy.

- **NOTE** the key findings and recommendations of CBRE work on the property market.

- **CONSIDER** the proposed regional arrangements to influence development activity in the region and the potential of these to address delivery issues.

Introduction

1. In December 2009 SEEDA commissioned research from CB Richard Ellis Ltd (CBRE) to better understand the impact of the credit crisis on the region's property market. The research also identified barriers to development going forward and made recommendations on action. Initial findings and recommendations were shared with over 200 regional stakeholders from across the public and private sector at a conference – *Beyond the Crunch: Building a stronger South East* on the 25th March 2009. The final report and recommendations is being finalised and will be published shortly.

Background

The current state of the development and construction sector

2. The housing and commercial property industry is a significant part of the South East economy; SEEDA's Construction Sector Consortia estimates that the industry employs over 375,000 people and generates £18 billion per annum in the South East. It was one of the first sectors to feel the effects of the recession with substantial job losses in both the trade and craft occupations but also amongst the development sector. Nationally the industry has contracted rapidly with high numbers of redundancies and a loss of skilled workers who may not return. Market soundings suggest that the industry may have lost up to 50% of its capacity. In the South East almost a third (32%) of all JSA claimants in April 2009 from the professional

/ higher skilled occupations were formally employed in built environment professions or the development industry.

3. Commercial development and housing projects, of all shapes and sizes are stalling across the region, both in areas in need of regeneration and also in those parts of the region considered prime property markets, such as the Thames Valley. At best, these schemes have been delayed in the short-term; at worst, a number will have been hit by major uncertainties and financing shortfalls, which will take many years, if not a decade, to recover.

4. In 2007/08 over 35,000 homes were built in the region, exceeding the figures in the South East Plan (Regional Monitoring Report for the South East Plan 2008). Government data based on returns from local authorities and the National House Building Council (NHBC) suggests that completions for 2008/09 were 27,830 and starts for 2009/10 were 19,000 (these figures are provisional and subject to revision). Starts are a good indicator of 2009/10 and 2010/11 completions. The implications are that this financial year and next year, there will be a serious shortfall in house building in the region. Private housing starts have almost halved but the proportion of social housing remains roughly the same due to public sector intervention, particularly changes in grant rates.

5. In terms of commercial development there has been a record fall in property investment values since mid 2007 (-40% on average). This fall was exacerbated by pressures on the occupational markets for commercial property as the effect of the recession was felt in the ‘real economy’. Completions of new commercial space are forecast to fall sharply over the next 2 years, with complex town centre schemes and regeneration schemes most vulnerable.

6. Since the Credit Crunch, lending by individual banks has generally been restricted to a cap of £50 million and a recent survey of 100 global lenders found only 12 prepared to consider loans of over £25 million. Development finance, where it is available, is only being offered to schemes with a heavy element of pre-lets. Bank finance to build housing for open-market sale is now virtually non-existent.

7. Many of the major house builders are now controlled by banks, which are likely to take a very cautious approach to funding development unless there is a clear and confirmed market. In the commercial sector tighter finance will see a growing importance of cash-rich purchasers, both domestic and overseas; traditionally the South East has tended to be less attractive to these investors.

Barriers to delivery

8. After finance, some of the most significant barriers developers cite at the moment are developer contributions (Section 106 and tariffs) negotiated in stronger market conditions. The phasing of developer contributions has also become a major issue. In the current market, there are very few circumstances where large capital receipts can be obtained from developers early in a project.

9. The balance of risk between the public and private sector is identified as something that will also need to change in the current climate. There has been a shift in investment risk from the public to private sector in recent years with the private sector asked to fund up front land assembly and infrastructure costs. But in the current climate this model is no longer sustainable. In many cases the private sector can no longer afford to carry the level of risk between scheme inception and delivery that it has in the past.

10. Developers also see the public procurement process as a constraint on delivery. Even before the recession, the complexity of the procurement process has been cited by many developers as a very real barrier to investment by the private sector. The procurement costs on a large strategic scheme can amount to many millions of pounds; in the current financial climate few developers are prepared to engage in the lengthy procurement processes now required by many local authorities.

11. The South East will gradually recover in the longer term, as the financial markets move towards some stability and the global liquidity position improves. However, developers are focused on bringing forward less complex sites and many have curtailed any strategic pre-planning activity. This lack of pre-planning and development work on strategic sites could contribute to a fundamental shortage of housing and commercial space in the South East in the longer term.

12. The significant loss of jobs and expertise over the past year in both the public and private sector will have a significant impact on the ability of the industry to respond to both an upturn and increased regulatory drivers. The notion of skills' shortages and skills' gaps in the sector were well established before the recession. There are now very real concerns across the industry that whilst skills shortages may be temporarily reduced, replaced by rising redundancies, in the longer term the lack of employment opportunities for new graduates will reduce the capacity of the industry and hinder the region's ability to respond as the economy moves to recover, and the South East resumes its ambitious physical development strategies. Meanwhile the recession has also highlighted critical skills gaps amongst the existing workforce and key decision makers, notable amongst these are the understanding of development finance.

Recommendations for action

13. CBRE's recommendations fall into three categories focused on:
    - The need for new models of delivery, with a greater sharing of risk and return between public and private sectors;
    - The need for improved and more transparent relationships between sectors; and
    - The implications of the above for delivery and particularly the skills, knowledge and understanding needed to work in the new environment.

New investment models

14. The South East's ambitious proposals for investment in infrastructure are going to require new sources of funding which go beyond that which the Government and major financial institutions are likely to be able to provide in the short to medium term. The Regional Infrastructure Fund is one step forward, but will need to be supplemented by new models which share risk and reward more appropriately between the public and the private sector.

15. 15. The CBRE work identifies new delivery models such as Tax Increment Finance Schemes (TIFS), along with greater use of public/private joint venture arrangements, including Local Asset Backed Vehicles (LABV) as the way forward. TIFs are potential mechanism for accelerating development by allowing investment in infrastructure to be financed from the increased property tax base that could be enabled by the existence of improved infrastructure.

16. The Government is also interested in developing new opportunities for innovative financing mechanisms. In the Budget the Government announced it will work with interested local authorities and city-regions to assess the scope of TIFs and has subsequently invited local authorities to put forward proposals to pilot such an approach to assess the potential benefits and costs (pilot proposals are invited by the 30th June 2009).

Prioritising Investment

17. Given the likely financing constraints over the short to medium term, not every project under consideration is going to be deliverable and the region is going to have to make some tough choices over the coming years as major investments have to be prioritised. GOSE and HCA, with the support of SEEDA, have made good progress in compiling a list of regionally significant housing sites and their current status to inform this process. So far they have identified 60 sites with a capacity for 22,000 homes that have either stalled or not started.

Improving public / private sector relationships and addressing skills gaps

18. Developers have indicated that as the market recovers they will focus their development activity on a smaller number of key local authorities who can demonstrate vision, clear priorities, leadership, a positive approach to development and a track record of delivery. Equally the public sector will be looking for a more honest and transparent approach, a greater commitment to place-making and an understanding of the political environment.

19. The skills implications of the CBRE report extend far wider than the training and development field. The new ways of working outlined in the report, and in particular, the new development models (TIFs, LABV and other joint venture arrangements), will mean that elected Members, local authority officers and the private sector, will need broader skill sets with a particular focus on financial skills. If the public and private sector are to engage more effectively and to build the types of relationships outlined in the report, much work also needs to be done around the culture of both local

authorities and their private sector partners. This needs real leadership to deliver across the region.

20. The CBRE report identified specific skills gaps such as an understanding of development finance and specific support to early career entrants. The CBRE report recommends a number of ways in which these gaps could be reduced for example through a ‘skills bank’ to access expertise or mechanisms for sharing expertise amongst local authorities. However, in a time of tight resources a more innovative approach is also needed to training, and in particular, given local authority budget cuts, to its financing. The CBRE report controversially recommends the introduction of a nominal voluntary levy on planning applications to be paid by developers as a means of raising circa £500,000 pa. to invest in the skills of those property professionals and elected Members.

Current action to support the sector

21. The Government has taken a number of steps to help stabilise the housing market and support homeowners in difficulty. The main elements are:

- A pilot scheme, called Rent to Home Buy, to support first time buyers into affordable home ownership;
- Extending the funding available to buy appropriate unsold stock from house builders for affordable housing;
- Examination, with local authorities and housing associations, of proposals for mortgage rescue schemes and other support for home owners;
- Shared equity scheme – HomeBuy Direct - offering time buyers the chance to get onto the property ladder;
- Mortgage rescue scheme to support the most vulnerable homeowners facing repossession to stay in their homes;
- a shortening, from 39 to 13 weeks, in the period before Income Support on Mortgage Interest for new working age claims;
- boost in spending power for social housing providers;
- stamp duty relaxation for purchases of residential property of £175,000 or less until September 2009.

22. The Homes and Communities Agency (HCA) is taking a lead role in delivering these initiatives as well as responding directly. HCA has introduced greater flexibility in grant levels for affordable housing that are mitigating the worst effects of the recession. In the most recent budget a new £400 million ‘Kick start’ programme has been introduced to support the delivery of stalled housing-led schemes with a minimum of 50 homes. There has also been a positive response to the HCA’s request for expressions of interest for their Private Rented Sector initiative (aimed at encouraging institutional investment into the private rented sector). However, many of these initiatives have been secured by bringing forward investment identified for future years and with tighter public spending forecast going forward the region faces a significant challenge to meet housing need.

SEEDA's Future role

23. As an Economic Development Agency, SEEDA has a strategic interest in ensuring that the region's offer to businesses is one of quality places, with sufficient and high quality business space to attract and retain investment, and housing of the right type, size and quality in the right place to attract and retain people with the level of skills needed to ensure the regions success.

24. SEEDA is working closely with the HCA to identify priority schemes for investment where development has stalled and is also considering how best to manage its own property assets with the objective of securing the most appropriate structure for attracting private finance to unlock key regeneration sites in the future.

25. Whilst we need to consider new models for delivery in a changed market, the overwhelming message from CBRE's work is the importance of the relationship between the development industry and the public sector going forward. The region needs a better understanding of the ways in which the public and private sectors can work more effectively together.

26. Over the past year, through its South East Excellence initiative, SEEDA has worked to improve public / private relationships by bringing together Councillors, officers and house builders and developers to create a safe forum for discussion. Feedback suggests that this has been successful in starting to change behaviour and attitudes.

27. With the refocus of the Agency's activities SEEDA will no longer be leading on this agenda, although at present there is no one organisation willing to take the lead. There will also be a loss of valuable development expertise and advice with the demise of the private sector led South East Excellence Advisory Board.

28. In the short term SEEDA will be talking to partners to develop a clear action plan for taking the CBRE recommendations forward however, it is increasingly clear that SEEDA's strategy of transferring the activity of the South East Excellence programme to the HCA will not be possible in the short or possibly medium term. The Agency will therefore need to influence the agenda through the new South East England Partnership Board and its Delivery Boards such as the Housing and Regeneration Delivery Board.

Summary

29. The development sector is important to the health of the region. Delivery mechanisms will need to be flexible in the future and access a wider range of funding, and will require new relationships. This, along with changing environmental standards and new technologies will need improved delivery skills. The organisations within the new governance arrangements will need to ensure that the region can respond to the demanding delivery environment.

30. SEEDA should continue to play a role in:
    - Influencing strategy and policy relating to physical development;
    - Ensuring that investment for local and regional priorities are aligned and support economic development, including spatial priorities (through the Partnership Board and its Delivery Boards such as the Housing and Regeneration Board);
    - Influencing Government on property issues which impact on businesses;
    - Ensuring the views of the development sector are heard at a regional level;
    - Influence partners to ensure the region has delivery, sustainability and design skills.

Communications Implications

31. The CBRE report will shortly be published, and we are considering the potential for a formal launch event. There will be a press release and we will be targeting specific journalists within the development sector. The report will also be made available on the SEEDA, South East Excellence and partner websites, along with a focus on these issues in the next South East Excellence newsletter.

Author: [redacted] Contact: [redacted]

Date: 9th June 2009