Finance, Regeneration and the Credit Crunch

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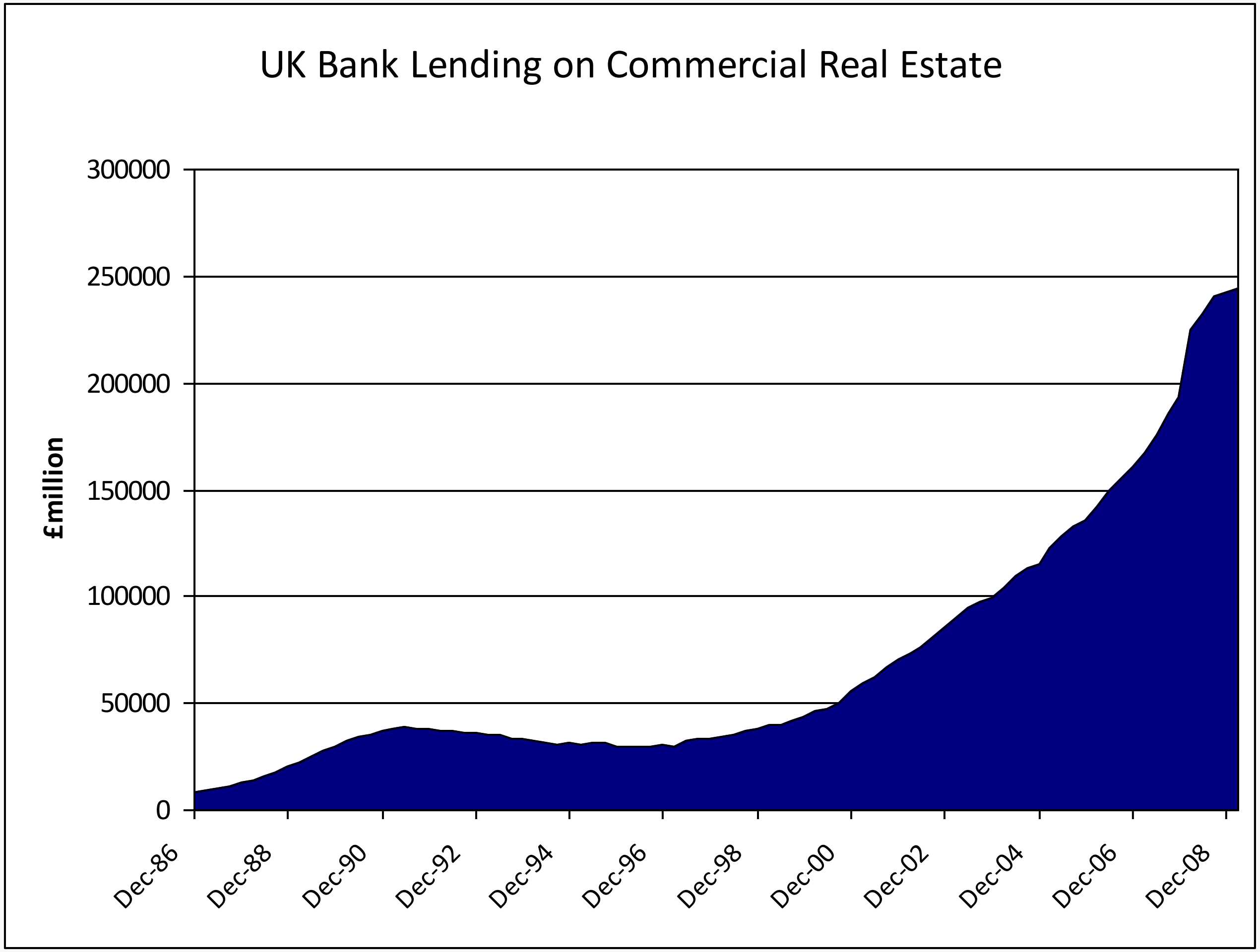
20 September 2009

Agenda

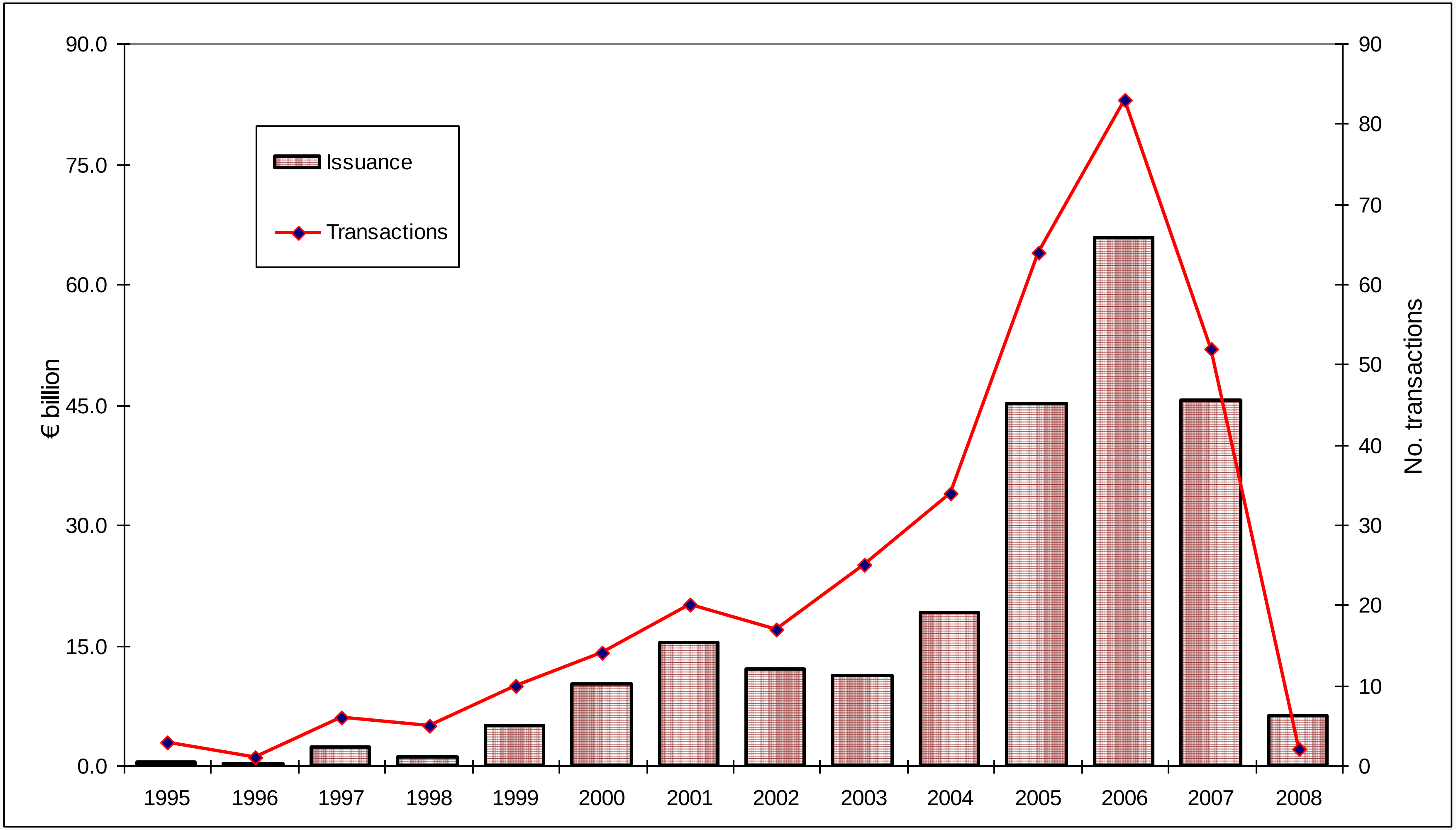
- Townshend and Daltrey (1966)
- Context: Gearing, Capital Values, the Credit Crunch
- Obtaining Capital for Development
- Public Sector Roles and Techniques
- Public-Private Finance: Issues and Questions
- Observations on Risk, Return and the Market

Gearing and Commercial Real Estate



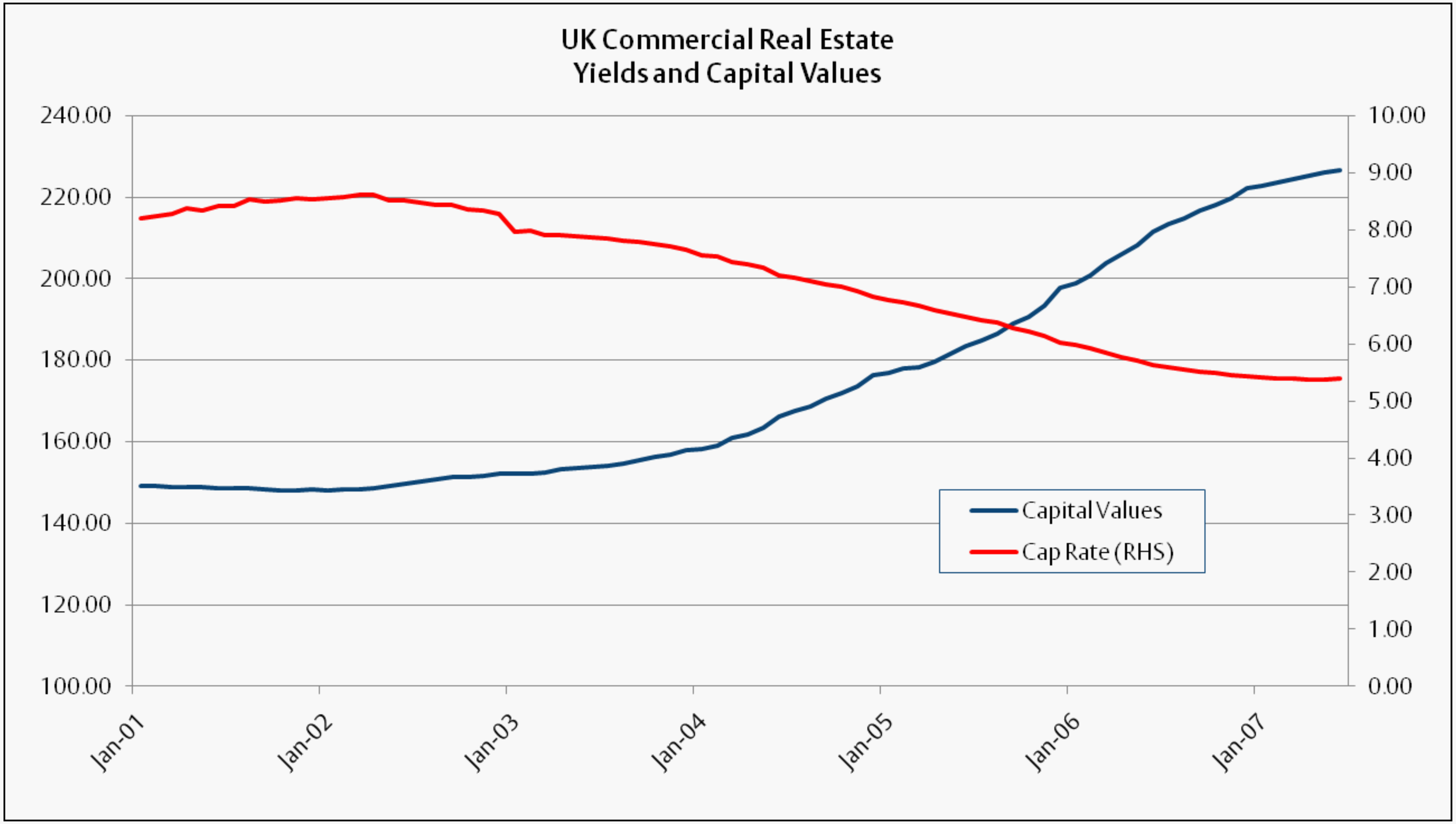
Q2 2009: £244billion outstanding … source, Bank of England

Context: European CMBS Issuance



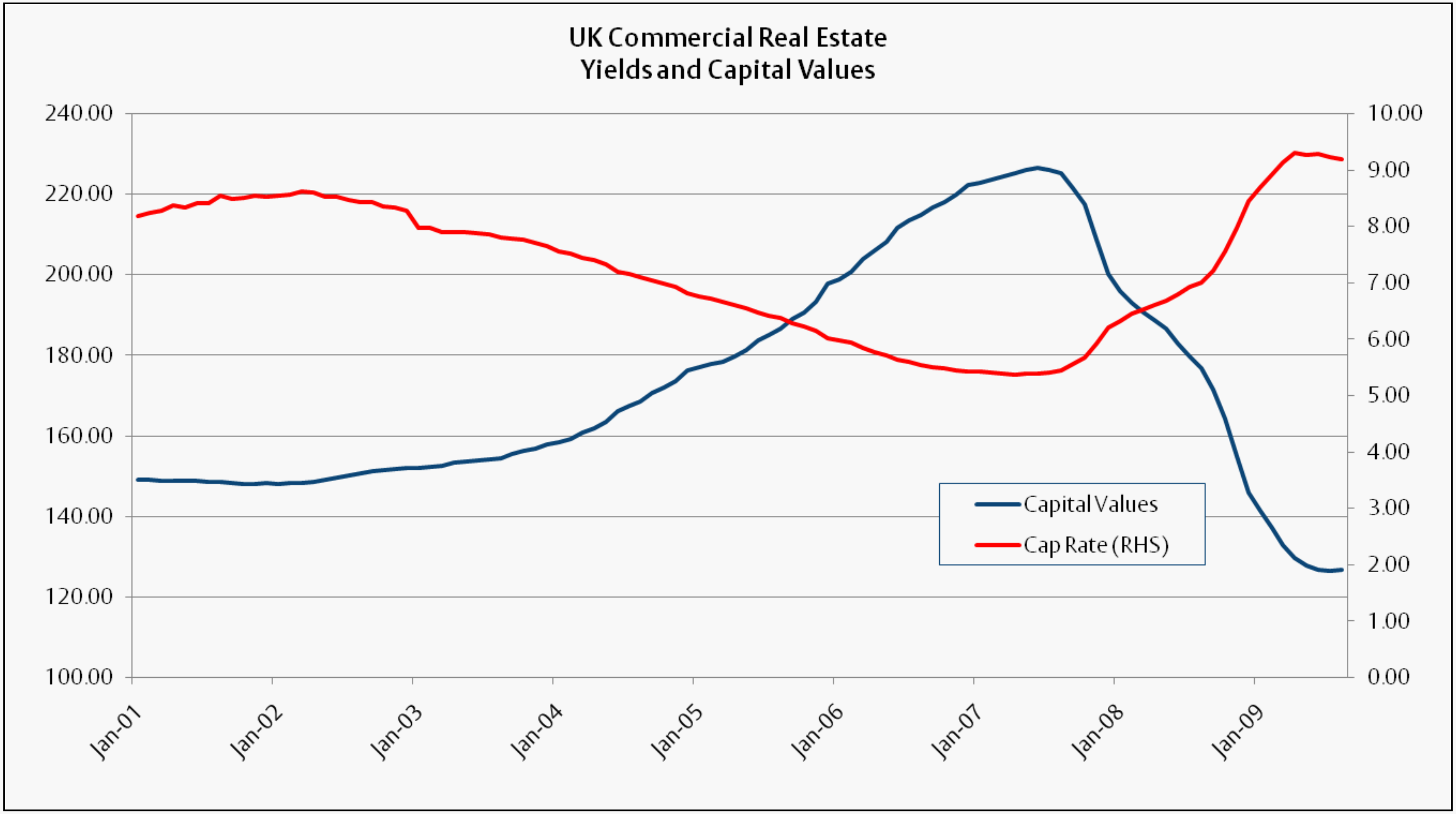
Source: Lizieri (2009), Barclays Capital, Moody's

Context: Falling Yields and Rising Values



Values rose by 52% January 2001 to June 2007. Source: IPD

Context: Value Gains Wiped Out Post-2007



Values fell by 44% June 2007 to July 2009. Source: IPD
Recall that a fall of 44% is reversed by a rise of 79%

Capital for Private Development Post-2008

- **Closing Down of Public Debt Markets**
  - *No direct capital market access or rate competition*
  - *"Originate and Distribute" models, loan book liquidity*
- **Shifts in Private Debt Markets**
  - *Credit and liquidity crises*
  - *Non-performing loan impacts and risk ratings*
  - *Regulation, Basel II (and III?) and capital adequacy*
  - *Margins, loan terms, security and flexibility*
- **Private Equity**
  - *A global crisis, not localised*
  - *Recovery funds, vulture funds and sovereign wealth funds*
- **Public Capital**
  - *Stabilisation measures, QE and public finances*
  - *"Discretionary" spending and "low priority" programmes*

Public Sector: Financial Roles and Techniques

- **Roles**
  - *Direct investment in infrastructure and regeneration*
  - *Partnership, risk sharing and support*
  - *Planning, coordination and regulation*
- **Existing Mechanisms**
  - *HCA, RDA, LA activity*
  - *PPP, Local Asset Backed Vehicles*
- **New and Proposed Mechanisms**
  - *Business Rates Supplement, Community Infrastructure Levy*
  - *JESSICA and Regional Infrastructure Funds*
  - *Tax Increment Financing / ADZs*

Public Sector Financial Inputs: Issues

- **New Mechanisms and Market Timing**
  - *"Glacial progress" versus "Not Now"*
- **The "TIF" Approach**
  - *Displacement and substitution effects*
  - *"Incremental revenue" – new build or value uplift?*
  - *Capital costs and revenue implications*
- **Competition and Incentives**
  - *Planning flexibility, development stance and tax incentives*
  - *Democratic choice and Tiebout effects*
  - *NIMBYism and coordination issues*
- **Risk and Return**
  - *Linking local finance to property and capital market cycles?*
  - *A fair share of risk – developers' profits in partnerships*

Some Observations …

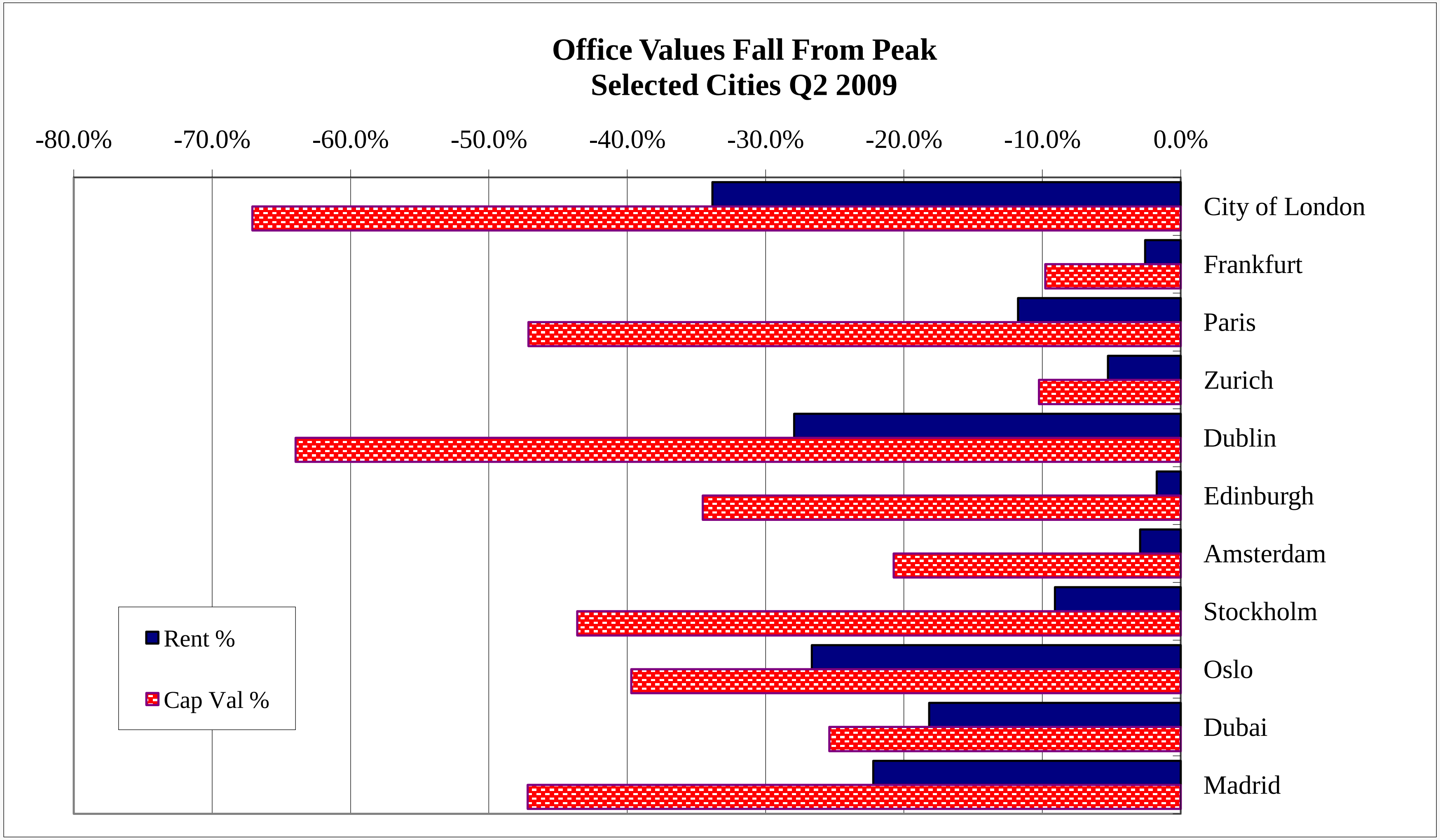
- **We Need More Financial Innovation Not Less …**
  - ***Post credit crunch perceptions and regulation***
  - ***Vanilla-plain finance and "the flight to quality"***
  - ***Debt securitisation is a <u>good</u> idea, not a bad one***
- **Long-Term Perspectives**
  - ***Short-term return chasing, efficiency and decisions***
  - ***Risk-return tradeoffs versus new paradigms***
  - ***Economic fundamentals matter***
- **Shifting Market Perceptions**
  - ***Gearing, Return and Risk – Asset Risk and Finance Risk***
  - ***How Risky is Regeneration Really?***
  - ***Are prime "institutional" investments really safer?***

Global Office Investment?

- **Heavy Concentration of Global Real Estate Investment**
  - *49% of 2007, 2008 deals were City offices*
  - *64% of deals, 79% of office deals in Global Financial Centres*
- **But Global Financial Centres are More Risky**
  - *Occupier, Investment, Development and Funding markets linked*
  - *Markets are linked across cities and regions*
  - *Vulnerable to linked shocks, systemic risks*
- **Impact on Risk of Investment Portfolios**
  - *Portfolios not well diversified*
  - *Ignoring fundamental risk drivers*
- **Implication – a Key Role for Local and Regional Markets**
  - *Must make the case*
  - *Must make the case in the right language …*

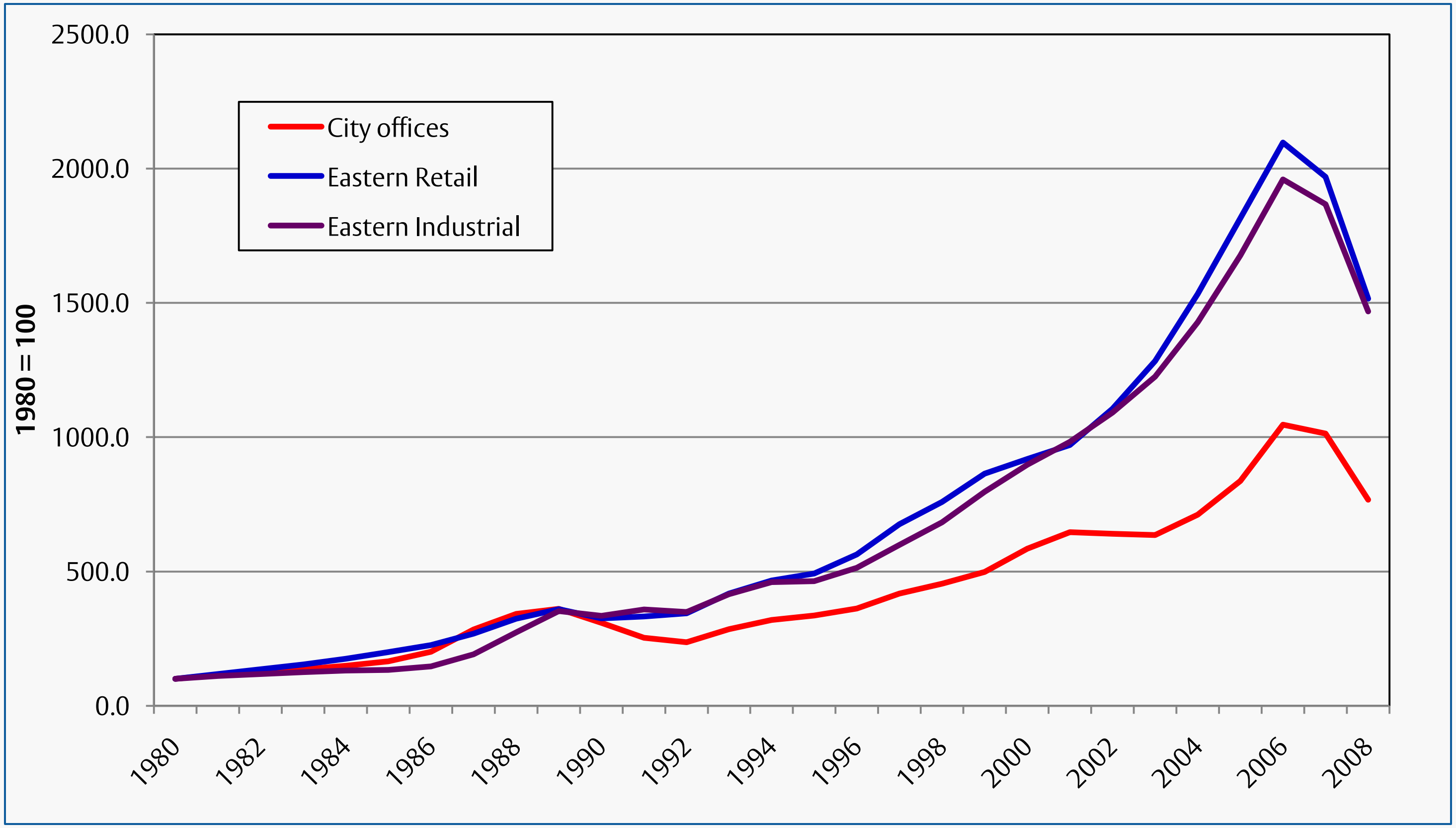
See: Colin Lizieri (2009) Towers of Capital, Chichester, Wiley-Blackwell

Investment Concentration and Risk



Source: CBRE/Lizieri

Real Estate Performance 1980-2008



- **Superior Risk Adjusted Returns <u>and</u> Diversification Benefits**
    - ***City offices*** ***7.5% p.a. return, 13.6% standard deviation***
    - ***East industrial*** ***10.1% p.a. return, 12.2% standard deviation***
    - ***East retail*** ***10.2% p.a. return, 10.1% standard deviation***

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