

REGENERATING BROWNFIELDS: INNOVATIVE FINANCING AND RISK SHARING VEHICLES

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ABSTRACT

This paper reviews the current challenges for the financing of urban regeneration in the light of the global credit crunch and the recent downturn in commercial property markets. At an international level governments are increasingly seeking to ensure greater involvement of the private sector in the financing and delivery of regeneration in urban areas.

The need to bring in more private sector funding at each stage of the regeneration process comprising remediation, development and investment phases, is witnessing the emergence of new funding vehicles crossing the traditional asset classes. The institutional asset classes represent potential funding opportunities for each of the regeneration phases. In addition there is increasing institutional appetite at a global level for investment in infrastructure which is a key component of the regeneration process.

The analysis of investment performance highlights that investment in regeneration does not significantly disadvantage an institutional portfolio. The levels of risk to which investors are exposed are not significantly greater in regeneration properties while returns achieved in regeneration areas over the last ten years across all property types have surpassed those achieved in the mainstream property market.

The potential for the application of UK REIT vehicles to the regeneration property market is considered somewhat limited given the current legislative obligations, particularly during the remediation and infrastructure and development stages of the regeneration process.

Keywords: regeneration financing vehicles, institutional asset classes, investment performance, REITs

1.0 Introduction

Around the world governments are increasingly seeking to ensure greater involvement of the private sector in the financing and delivery of regeneration in urban areas. In the UK regeneration is a government priority in terms of ensuring greater input of the private sector in

the financing and delivery of regeneration and sustainable community targets. However, the scale of institutional capital targeted towards the regeneration process has been limited. This is a particular concern where major regeneration schemes such as Thames Gateway and many others will manifestly require enhanced participation by institutional investors.

This paper reviews the current challenges for the financing of urban regeneration in the light of the global credit crunch and the recent downturn in commercial property markets. The slowdown in residential property markets at a global level also has significant adverse implications for regeneration as so many large scale renewal projects incorporate housing components.

The need to bring in more private sector funding at each stage of the regeneration process comprising remediation, development and investment phases, is witnessing the emergence of new funding vehicles crossing the traditional asset classes. The institutional asset classes represent potential funding opportunities for each of the regeneration phases. In addition there is increasing institutional appetite at a global level for investment in infrastructure which is a key component of the regeneration process.

It is now recognised that regeneration offers significant investment opportunities, findings which challenge preconceived notions and suggest that opinions of low investment returns in such areas are incorrect. Hence, there is a need to reconsider strategies regarding the investment potential of real estate within regeneration/urban renewal areas (McGreal et al, 2006).

The next section of the paper addresses regeneration and prime property investment in the current phase of the market cycle. Following sections include an overview of the regeneration process and the characteristics of funding vehicles (section 3.0), current and emerging models of regeneration financing (section 4.0), analysis of regeneration performance (section 5.0), potential for a regeneration REIT (section 6.0) and conclusions (section 7.0).

2.0 Regeneration & Investment in the Current Property Cycle

The global credit crunch and recent downturn in the commercial property market in the UK represent a significant challenge for urban regeneration in terms of attracting private sector investment.

Ironically, the downturn in the property market comes at a time when a growing acceptance of the opportunities and potential of regeneration property had begun to emerge among major institutional investors following the creation of the urban regeneration index (IPD, 2007).

The level of investment currently being channeled into property has already begun to recede in response to the adverse market conditions. The Association of Real Estate Funds (AREF) reported outflows in the unlisted property funds sector of £939 million in the third quarter of 2007, more than five times the withdrawals for the same period in 2006. Over the quarter £800 million was invested in the unlisted fund sector but this equates to less than half the amount invested in the third quarter of 2006 and meant that capital flows within the unlisted property funds sector were negative for the first time since March 2003 (AREF, 2007).

Given the sea change in property market conditions the following key questions need to be addressed:

- Will regeneration property prevail in the current market downturn and continue to provide an attractive investment option for investors?
- Will regeneration schemes attract the required levels of private sector investment to sustain the urban renaissance?
- What new vehicles are likely to attract a wider range of private sector funding into regeneration?

Traditionally, the prime property market is considered to offer the most resilient investment option for property investors during a market downturn, with location and tenant covenants among the factors contributing to the robustness of prime properties. Prevailing market conditions will adversely impact upon the performance of all properties but unlike the prime property market which is highly dependent on the investment market in terms of income generation regeneration properties offer investors the opportunity to add value at the asset level through processes of remediation and development.

Previous research (Adair et al, 2004) highlighted that regeneration property could potentially shelter investors from a downturn in the market. The last time the UK property market experienced a downturn was in the three-year period 1990-1992. The IPD all property index posted returns of -8.4% (1990), -3.1% (1991) and -1.6% (1992). In the same time period property in areas undergoing regeneration continued to achieve positive rates of return, 3.4% (1990), 6.7% (1991) and 4.2% (1992) respectively. Over the three year period only the office sector within regeneration areas (1990) recorded negative returns. The office sector, due to the extent of oversupply was most adversely affected by the correction in the market, the IPD mainstream office index posted returns of -10%, -10.8% and -7.2% over the three year timeframe.

The positive returns achieved in regeneration areas in the previous downward cycle must be contextualised. Regeneration property in the early 1990s benefited from extensive levels of subsidisation. The subsidisation in many ways had a cushioning effect on the regeneration property market enabling it to achieve positive returns during the property market downturn. The levels of subsidisation available in the early 1990s is not available in today's regeneration property markets, nonetheless a number of the major regeneration projects being undertaken in the UK are public-private partnerships and involve substantial land and capital commitments on behalf of the public sector bodies. Land acquisition is the major initial expenditure of the property development process but in regeneration partnerships, the public sector partner is very often the existing landowner of the sites being brought forward for development. Land and buildings often represent the contribution of the public sector partner to the regeneration partnerships but the fact that land acquisition costs are significantly reduced or eliminated completely mean that regeneration should continue to provide investors and developers with a potential cushion from prevailing market conditions, indeed such schemes may even seem more attractive in the current climate than they had during the sustained period of growth with schemes providing gap funding likely to generate most interest.

The private sector has traditionally looked to the public sector to provide economic viability and reduce risk in periods of uncertainty, and from that perspective the economic downturn could well mean that major regeneration schemes undertaken in partnership with public sector bodies could benefit from enhanced levels of investment. Regeneration provides investment opportunities across the remediation/infrastructure, development and investment stages and increasingly the public sector is seeking new models for sharing risk and return thereby attracting new sources of private sector funding.

3.0 Regeneration Process Characteristics of Funding Vehicles

Regeneration is considered as a process consisting of three distinct but overlapping phases: remediation/infrastructure provision, development and investment (Adair et al, 2006). The phases mirror the wider urban land development model however there is added complexity within regeneration arising from the location of sites, primarily in inner city areas, the secondary nature of sites from a property market perspective, the perceived adverse impacts of neighbouring land uses and associated social and environmental problems.

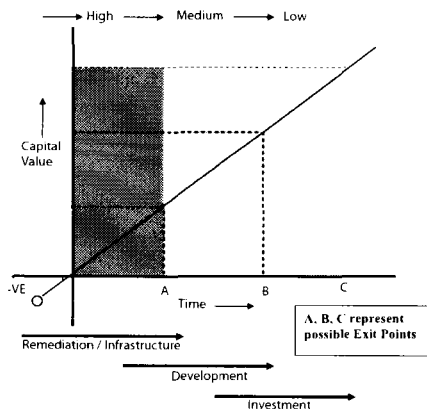
The initial phase of the regeneration process comprises the assembly of the site, remediation of the land, if necessary, together with the provision of infrastructure to facilitate the proposed land use. While the remediation process has seen considerable technological innovation with the availability of tax credits for site cleanup the provision of infrastructure continues to raise major challenges in terms of financing. Often infrastructure is a critical component in releasing sites with development potential, but high initial upfront expenditure can deter private sector involvement. This phase of regeneration has attracted certain, though limited, institutional investment through bond issues.

The second phase involves the development of the property asset. The skills base for the management

of this process lies within the development community, which is often identified as the short-term risk-taker within regeneration. This part of the process, in common with any development project, is traditionally debt-financed through banks and lending institutions with decisions made on the basis of finely-tuned appraisal models.

The third phase of the urban land development model concerns the sale of the asset to the investment community which can occur at differing times depending upon the strategy of the developer. Traditionally, this phase has been the point of entry for institutions holding property as an investment asset with added diversification benefits. For regeneration property, the extent of institutional involvement has been noticeably low due to perceptions of risk and return. However, in recent years there has been an increasing weight of institutional investment entering regeneration as part of the allocation of investment capital to capital property asset class.

Figure 1: Regeneration phases and risk profiles



Investment

Each phase of the regeneration process has distinct characteristics within the overall risk-return continuum (Figure 1), from the remediation/infrastructure phase, characterised by high levels of risk but with the opportunities for high returns, to the investment phase at the other end characterised by lower risk and corresponding lower levels of return, with secure revenue streams and more predictable capital values resulting from the occupied development entering the property market. Intermediate points

include the potential risk of an unfinished building through to the completed building remaining unlet, lacking an income stream, having uncertain capital values and not being taken into the established investment market. In compensation for these risks, the developer expects higher returns. Over time the liquidity of the regeneration property asset increases (Figure 1) with exit points based on predetermined valuation dates or market driven.

The institutional asset classes, as a source of finance, represent potential funding options for each of the regeneration phases, which are characterised by a spectrum of low to high risk/return profiles, capital and dividend returns and holding periods matching those of the regeneration phases. Traditionally what has been sourced has originated from the institutions' property allocations. However such investment is increasingly being recognised as matching the demands of quasi-private equity. In addition there has been some limited investment through bond issues at the infrastructure stage whereas the investment phase is the typical entry point for institutional investors into regeneration.

4.0 Current and Emerging Models of Regeneration Financing

There are a number of recognised regeneration property investment vehicles operating currently in the UK. The Igloo Fund provides the prospect of the superior returns that regeneration can offer illustrating that over time, genuine SRI investment may outperform traditional market returns.

The Igloo Regeneration Fund (Igloo) is a UK Limited Partnership managed by Morley with Igloo Regeneration Limited as the development manager. The objective of Igloo is to deliver long-term social, economic and environmental revitalisation by investing in the physical regeneration of the top 20 cities across the UK. Investment is focussed on areas achieving European Regional Development Fund objective 1 and 2 status, UK Assisted (Tier 2) Areas, European URBAN Programme Areas and other UK Urban Priority Areas.

Igloo currently has over 20 regeneration projects across its direct development and partnership portfolios with a completed development value of £2.5bn. The projects when complete will bring back into use over 250 acres of brownfield land and create over 8,500 new homes and 10,000 jobs. The Igloo fund is due to be wound up in 2016 although does have an option to break in 2011, but this is unlikely to be exercised. At the end of September 2007 the fund had capital commitments of circa £130 billion. Investor returns for the fund are forecast at 12% IRR per annum over the life time of the fund.

A more recent example of recognised good practice is Blueprint, an innovative public private partnership comprising East Midlands Development Agency and English Partnerships together with Morley Fund Management's Igloo Partnership's Igloo Regeneration Partnership.

Blueprint is a 50:50 public-private partnership created to develop new solutions for regeneration in the East Midlands. The partnership comprises East Midlands Development Agency (EMDA) and English Partnerships (EP) from the public sector along with Igloo Regeneration from the private sector. Blueprint has equity commitments of circa £25 million; divided evenly between the private and public sectors. Private sector partner Igloo has invested 50% (£12.5 million) of the initial equity, with East Midlands Development Agency (EMDA) and English Partnerships both investing £6.25 million. Blueprint has the potential to combine its £25 million of equity with a further £25 million of bank debt.

The Blueprint property portfolio, purchased from EMDA and EP includes around £30m worth of land and buildings. The buildings are located throughout the east midlands. The land is in three (Derby, Leicester, Nottingham) of the six (the others are Corby, Northampton and Lincoln) urban priority areas within the Urban Action Plan for the east midlands. The initial regeneration portfolio has a completed development value of around £500m. Blueprints first project – the Nottingham Science Park is due to complete later this year.

Current evidence suggests a widening of instruments used within regeneration with opportunities comprising large mixed used developments frequently involving joint ventures. In addition a number of institutions are increasing their exposure to urban infrastructure such as toll roads and bridges as part of their alternative investment strategy. In spite of long gestation periods and a significant exposure to risk the potential returns are significantly greater than comparable fixed-income products. Transferring this arrangement to regeneration creates the opportunity to structure a long-term investment vehicle that would reward early stage investors in the infrastructure and development stages of regeneration.

Research undertaken by Newell (2008) confirms an increasing institutional interest in the strong inter-relationship between infrastructure quality and global competitiveness. The US and UK currently rank 12th and 14th in the world respectively in terms of infrastructure provision with Germany the top ranking country in terms of infrastructure quality followed by Switzerland and Hong Kong (Newell and Peng, 2008). The investment gap in both the developed and developing countries has created a significant investment gap with governments increasingly looking at alternative ways to fund infrastructure, development and maintenance. The alternative private funding options for private infrastructure have largely included public private partnerships (PPPs), private sector entrepreneurial projects and private finance initiative schemes (Newell and Peng, 2008)

Figures published by the World Bank (2006) calculate that over \$30 trillion will be required to fund global infrastructure to 2030 creating significant investment opportunities. This has led to the emergence of infrastructure as separate asset class for institutional capital providing investors with distinctive characteristics and attractive features. Over 25 new unlisted infrastructure funds were established in 2004-2006 (average fund size \$700 million) incorporating both local and international infrastructure portfolios in established markets (Europe, Australia, Canada) as well as in

emerging markets (Korea, Eastern Europe, Latin America, South America). Typically pension funds utilise unlisted property funds to secure exposure to a range of infrastructure projects both local and global (Newell and Peng, 2008).

The two main global listed infrastructure performance series are the UBS Global Infrastructure and Utilities Index and the Macquarie Global Infrastructure Index. At the end of 2006 the UBS index comprised 242 companies/funds with a market capitalisation of \$1.7 trillion. Funds investing in US infrastructure posted annualised returns of -0.4% over seven year period 2000-2006. Funds investing in global infrastructure funds achieved an average annual return of 18.15%. The contrast in performance levels was attributed to the maturity of the European (particularly toll roads) and Australian infrastructure markets while the US infrastructure market is at the development stage. Direct US real estate achieved 11.94% over the same period with REITs achieving annualised returns of 22.27%. Annualised returns for stocks and bond were 1.11% and 6.79% respectively over the seven year time frame (Newell and Peng, 2008).

The consensus industry view is that infrastructure should be treated as a separate asset class from real estate. While they similar investment characteristics and infrastructure is real estate related they have significant differences and should therefore be treated as separate asset classes RREEF, 2005, Hopkins, 2007). The correlation analysis suggested that US infrastructure provides potential diversification benefits within a real estate, real estate related and mixed asset portfolio. Investment correlation between US infrastructure and US real estate ($r=0.28$) or US REITs ($r=0.23$) was not significant suggesting potential diversification benefits. Also of significance is that US pension funds investing in infrastructure can still realise diversification benefits be investing in infrastructure in Australia and Europe.

The UK Government has stressed the public sector commitment to regeneration through a projected investment of £9 billion of cross-government funding to the regeneration of the Thames gateway alone over the next three years. In addition,

new funding vehicles are being developed such as the Community Infrastructure Levy (CIL), Supplementary Business Rate (SBR) and Local Asset Backed Vehicles (LABV) which will provide local authorities with revenue generating streams to fund infrastructure provision and contributing to the economic viability of regeneration schemes.

The Community Infrastructure Levy (CIL) legislation is currently being passed through parliament as part of the Planning Reform Bill. The CIL will enable local councils to apply a levy on new developments in their areas to support infrastructure delivery including the provision of schools, leisure facilities, health centers, flood defenses as well as transport and strategic infrastructure. It is intended that the CIL will be applied on both residential and commercial development as this will ensure that all developments which impact upon infrastructure contribute towards the cost of its provision. The CIL will be a standard charge decided by designated charging authorities with liability likely to be attached to the landowner at the point of commencement of development.

Existing standard charging regimes use a variety of different bases for determining the contribution. These include floor and site area; number of dwellings; or number of bedrooms. The Planning Reform Bill will set out what bases could be used for the CIL to allow local planning authorities sufficient flexibility to tailor their charging regime to suit their local are and is expected to follow the principles set by the Milton Keynes Tariff. The Milton Keynes Tariff was accepted by Government in December 2005 as an approach to fund the infrastructure needed for the next phase of growth for Milton Keynes to 2016. The tariff requires a contribution of £18,500 per residential dwelling and £260,000 per hectare of employment space from developers to pay for a share in the local and strategic infrastructure required to support this growth. The tariff is forecast to raise £310 million up to 2016 with additional funding being required to cover the full cost of growth.

The introduction of a Supplementary Business Rate (SBR) was proposed by the Lyons Inquiry in their final report into the future role, function and

financing of local government published in March 2007. The Inquiry recommended that Government should consider giving local councils the power to raise a supplement on top of the business rate to fund specific, local economic development projects. The report commented that the time was not right for a re-localisation of business rates, highlighting that this would also be technically difficult and suggested that the introduction of a SBR would enable local authorities to have more control over how to raise new local revenues to invest in local infrastructure and economic growth.

The Government White Paper: Business Rate Supplements (October 2007) outlines the proposed model for Business Rate Supplements and the protection offered to businesses. Fundamentally local businesses will have a strong say in the decision to raise a supplement, and how it should be spent. There is also a requirement for accountability at local authority level to ensure that levies raised are spent on economic development in addition to existing plans within the local area. Government proposals also include the introduction of a national upper limit of 2p in the pound to ensure effective use of the additional revenues available to the local authorities as well as providing reassurance to businesses about the scale of potential costs. Smaller business will be protected from disproportionate burdens, with properties liable for business rates with a rateable value of £50,000 or less exempt from paying the supplement. Government will legislate to enable local authorities to levy the first supplements by April 2010. SBR shares many characteristics with the already established levies applied to businesses within Business Improvement Districts (BIDs). The SBR proposals have however received strong opposition from among others RICS, the British Chambers of Commerce and the Federation of Small Businesses.

The creation of Local Asset Backed Vehicles (LABVs) will enable local authorities to use their assets (usually land) to lever investment from the private sector to finance the delivery of major regeneration projects. LABVs are designed to deliver regeneration in a more strategic manner by

pooling the assets, project expertise and planning powers of the public sector with investment, financial expertise and asset management skills from the private sector into a corporate structure that ensures an acceptable balance of risk and return for all partners.

There is no set format for the design of an LABV. Local authorities have varying capacities, assets and ambitions, therefore the LABV must be tailored to meet the specific needs of the local authority. In the initial instance local authorities and other public bodies should collaborate to identify a portfolio of assets and a pipeline of regeneration projects that require funding. This collaboration is then formalised into one company with a single governance structure – the LABV. Summary details of the portfolio, together with an outline business plan for each individual asset and regeneration project are circulated to potential investors. It is important that the portfolio comprises an asset mix that is likely to appeal to the investor grouping being targeted. Outline bids for the portfolio are then received and once investors have been secured a hands-on management team is formed to oversee the running of the company.

The LABV structure has the potential to create a self sustaining cycle of regeneration funding. Packaging assets and developing them sequentially allows for the establishment of revenue streams that support development over time. Asset backed vehicles provide returns to both the private and public sector partners, with a share of the profits being reinvested in future regeneration programmes. The asset backed structure is already operating successfully at regional level, the Blueprint model in the East Midlands is one of the most high profile examples, while a number of local authorities including Croydon, Hull, Liverpool and Newcastle-Gateshead are actively investigating the creation of asset backed vehicles.

5.0 Regeneration Performance Analysis

This section of the paper analyses the risk-return characteristics of regeneration property in the UK, benchmarking the performance of the IPD regeneration index against the IPD UK annual property index (IPD, 2007). Total return is used as the performance benchmark with standard deviation in total return used to assess risk. The correlation between regeneration property and the other major asset classes is also examined to discover if regeneration property could provide diversification benefits within a multi-asset investment portfolio.

In the ten period 1997-2006 total returns for all property in regeneration areas have outperformed the IPD all property index (Appendix 1). Annualised ten year returns for all property in regeneration areas is 13.8%, the IPD all property index achieved annualised returns of 13.6% over the same time period. Annualised returns for all property types over five year period 2002-2006 also demonstrate the robustness of regeneration properties as an investment option, annualised returns for all property types in regeneration were 16.7% over the five years, the IPD all property index posted annualised returns of 15.2% over the five year period.

Offices were the best performing sector within regeneration areas in the period 1997-2006 (14.2%), outperforming the IPD office index by 1.3% over the ten year time frame. Retail properties in regeneration areas (13.9%) underperformed the IPD retail index which posted 10 year annualised returns of 14.1%. The underperformance of retail sector property within regeneration areas is significant given that retail properties comprise 75% of the index by capital value (Table 1). The underperformance is marginal however, (0.2%) over ten years and includes the period pre-regeneration. Retail properties in regeneration areas have in fact outperformed their respective benchmark in six of the last ten years with retail warehousing and shopping centres in regeneration areas delivering particularly strong rates of return over the last three years. The outlook for retail property in regeneration areas over the long-

term remains good as successful regeneration substantially increases local population incomes and improves the quality of retail catchments. The industrial sector within regeneration areas delivered 10-year annualised returns of 14.1%, marginally underperforming the IPD industrial sector index which posted annualised returns of 14.4% over the 10 years.

Five year annualised returns show that regeneration areas outperformed the main IPD indices across all three sectors of the property market in the period 2002-2006. The greatest level of out performance was again in the office sector with offices in regeneration areas achieving annualised returns of 17.1% over the five years. The IPD office index posted annualised returns of 13% over the same timeframe. Retail and industrial properties in areas undergoing regeneration achieved marginal out performance of their respective IPD benchmarks, 0.1% for retail and 0.4% for industrial over the five year timeframe.

Risk, measured as the standard deviation in total return over the ten year timeframe was not found to be significantly greater in regeneration areas. The standard deviation in total return for all property types within regeneration areas over the ten year timeframe was 4.7%. The standard deviation of all property types in the IPD annual property index was 4.3%. Analysis of the retail and industrial sectors over the ten years showed that the volatility in returns for regeneration properties were not significantly greater than those experienced in the mainstream property market while within the office sector, regeneration properties actually offered a less volatile investment option than the mainstream office market.

Regeneration property can provide potential diversification within a property investment portfolio. The correlation between the IPD mainstream office index and regeneration office index (0.175) is highly significant and suggests that there are diversification benefits to be realised, something that maybe of particular interest to investors investing exclusively in the office sector. Within a multi-asset investment portfolio the

diversification benefits of investing in regeneration property are similar to that achieved by investing in the prime property market. The strong correlation (0.826) between the prime property market and the regeneration property market for all property types mean that little additional diversification benefits are likely to be realised within a mixed asset portfolio that already includes a diverse prime property asset mix.

The analysis highlights that investment in regeneration does not significantly disadvantage an investment portfolio. The levels of risk to which investors are exposed are not significantly greater in regeneration properties while returns achieved in regeneration areas over the last ten years across all property types have surpassed those achieved in the mainstream property market. The office sector in particular offers investors an attractive investment from both a diversification and performance perspective. Returns for offices in regeneration shown marked out-performance of their respective benchmark over both five and ten year timeframes. Only in recent years (2004-2006) have offices in regeneration areas not outperformed their respective IPD benchmark and this has been a result of the exceptionally strong performance of the London office market in the last three years. Over the long term regeneration offices have outperformed their peer group comparator (excluding London) with returns less volatile than the UK average.

Table 1: Property Sector Weightings (December 2006).

Sector	IPD UK Annual Property	IPD Regeneration Index
Retail	47.2%	75%
Office	34.6%	9%
Industrial	14.8%	13.5%
Other	0.4%	2.5%
Total	100	100

- Weightings expressed as a percentage and based on Capital Value

IPD Annual Index – based on 12,137 properties with capital value of £191.7 billion (49% of the total assets of UK institutions and listed property companies).

6.0 Potential for a Regeneration REIT

REITs were introduced in the UK on 1st January 2007 following recommendations in the Barker report on housing supply (Barker, 2004). At the end of December 2007, 18 companies, with a market capitalisation of circa £26.3 billion (www.reita.org) had adopted REIT status. The UK Treasury received circa £1 billion in the form of conversion charges, a one of payment, paid as corporation tax and based on 2% of the gross market value of a company's assets when they adopted REIT status. The total property market value of the UK REITs at the end of December 2007 was £62.5 billion. The portfolios of British Land (£15.9 billion) and Land Securities (£14.8 billion) equated to almost 50% of the total property market value.

The performance of REITs in their first year has been adversely affected by the uncertainty within global investment markets. The credit crunch combined with the downturn in the UK property market in the third and fourth quarters of 2007 ensured that returns for the UK REIT sector in the first 12 months were negative. The EPRA/NAREIT/UK index, set up to measure and track the performance of UK REITs posted annual returns of -34.8% for 2007. REITs have also been affected by the unsustainable levels of return within the listed property sector in the period leading up to their introduction. Referred to as the "REIT bubble" the returns achieved within the property equities market in the period 2004 - 2006 (43%, 23.3% 41.3%) were unsustainable, and resulted in a correction in market values in 2007.

The performance of REITs in the first year of trading should not detract from their credibility as a viable investment option. REITs must be judged over the long term, the structure will improve accessibility and liquidity within the property investment industry and therefore to dismiss REITs after twelve months would be premature. The introduction of REITs has the potential to attract substantive levels of new investment into the property sector both nationally and internationally but will the development of REITs attract substantive levels of investment into regeneration property?

The potential application of the REIT structure to regeneration is somewhat restricted by current legislation. The restrictions are not bourn out in one specific element of REIT legislation but in a combination of parameters that govern REIT activities and portfolio characteristics. This is most apparent in the remediation and infrastructure and development stages of the regeneration process. Regeneration properties tend to suffer from a lack of income stream in the first two stages of the regeneration process, if an income stream is available this is generally retained often to service loans rather than distributed to investors something which is inconsistent with current REIT legislation. In addition the current restrictions on development activity combined with the parameters on portfolio composition and asset valuation mean that REITs, or at least the "qualifying" element of the companies are unlikely to be actively investing in regeneration at the remediation and infrastructure or development stages of the regeneration process. REITs do however have the potential to offer an attractive exit route for developers and specialist regeneration providers at the investment stage of the regeneration process.

7.0 Conclusions

Governments are increasingly seeking to ensure greater involvement of the private sector in the financing and delivery of regeneration in urban areas however it is widely recognised that the scale of institutional capital targeted towards the regeneration process has been limited. The fact that major regeneration schemes in the UK such as Thames Gateway will manifestly require enhanced participation by institutional investors poses significant challenges to policy makers and practitioners in their attempts to lever in enhanced private sector investment into regeneration areas.

In order to attract greater institutional investment into regeneration stronger linkages need to be built with the property asset class in terms of existing institutional regeneration funding vehicles ranging from single scheme vehicles to those financing portfolios of schemes. A greater understanding is required by policy makers and practitioners

of property as a 'hybrid' investment possessing the return characteristics of both equities and bonds but on the downside suffering from risks of illiquidity, capital depreciation and high transaction costs.

There are a number of recognised regeneration property investment vehicles operating currently in the UK for example, the Igloo Fund and Blueprint provide the prospect of the superior returns that regeneration can offer illustrating that over time, genuine SRI investment may outperform traditional market returns. The growth of hybrid vehicles spanning the asset classes indicates the investment opportunities that regeneration affords to institutional investors.

The analysis of investment performance highlights that investment in regeneration does not significantly disadvantage an institutional portfolio. The levels of risk to which investors are exposed are not significantly greater in regeneration properties while returns achieved in regeneration areas over the last ten years across all property types have surpassed those achieved in the mainstream property market.

The potential for the application of UK REIT vehicles to the regeneration property market is considered somewhat limited given the current legislative obligations, particularly during the remediation and infrastructure and development stages of the regeneration process. The lack of income stream in the first two stages of the regeneration process coupled with the restrictions on development activity mean that REITs would be unable to invest in regeneration schemes until the investment stage or at the earliest the latter stages of the development process. Nevertheless it is considered that potential opportunities may be found as REITs become more established in the UK property market.

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APPENDIX 1: Asset Class Returns 1997-2006

Year	IPD Direct - All Property	IPD Direct - Retail	IPD Direct - Office	IPD Direct - Industrial	IPD Regen All Property	IPD Regen Retail	IPD Regen Office	IPD Regen Industrial	Equities - All Share	UK Bonds	Property Shares FTSE	HSBC Pooled Property Funds*
1977	26.4	29.7	23.4	34.8					48.6	44.8	81.4	25.8
1978	25.6	31.5	22.8	28.7					8.6	-1.8	12.5	19.9
1979	22.8	25.2	20.4	27.5					11.5	4.1	21.5	23.1
1980	17.5	19.4	16.9	17.1					34.8	20.9	44.4	18.7
1981	15.0	17.3	15.1	12.1					13.6	1.8	4.8	16.3
1982	7.5	10.4	6.7	5.7					28.5	51.3	-5.2	8.3
1983	7.6	12.3	5.5	6.1					28.8	15.9	35.1	8.4
1984	8.8	13.9	6.9	6.0					31.6	6.8	23.5	9.9
1985	8.3	12.7	7.8	3.5					20.2	11.0	8.4	9.8
1986	11.3	11.8	12.2	9.3					27.3	11.0	24.8	8.5
1987	26.0	20.9	30.8	25.2					8.0	16.3	23.7	16.2
1988	29.5	24.9	31.2	39.5					11.5	9.4	27.8	30.5
1989	15.4	9.9	16.6	28.8					36.1	5.9	5.3	15.5
1990	-8.4	-8.3	-10.0	-3.5					-9.7	5.6	-18.1	-9.6
1991	-3.1	3.2	-10.8	9.1					20.7	18.9	-13.5	-2.1
1992	-1.6	3.5	-7.2	1.3					20.5	18.4	-12.6	-2.2
1993	20.2	20.8	19.4	21.3					28.4	28.8	89.1	15.5
1994	11.9	13.0	10.7	11.8					-5.9	-11.3	-18.6	13.9
1995	3.6	4.1	3.0	2.8					23.8	19.0	6.9	10.7
1996	10.0	11.8	7.6	10.3					16.7	7.7	28.0	8.6
1997	16.8	18.7	14.6	16.5	16.4	17.8	8.6	16.4	23.5	15.0	24.6	15.8
1998	11.8	11.5	11.6	13.3	11.3	11.8	8.5	11.3	13.8	19.4	-19.9	13.2
1999	14.5	14.1	14.4	17.7	14.7	14.4	15.5	17.2	24.2	-3.2	16.5	15.0
2000	10.5	6.6	15.5	13.8	6.7	5.9	10.8	11.6	-5.9	9.8	19.0	2.8
2001	6.8	5.5	7.6	8.2	5.8	4.8	12.7	8.1	-13.3	3.9	-6.0	6.6
2002	9.6	14.1	3.3	10.8	13.2	13.3	15.7	11.3	-22.7	10.3	-2.1	8.8
2003	10.9	15.5	3.2	11.2	16.0	16.8	15.3	12.4	20.9	1.8	30.6	11.8
2004	18.3	20.5	15.2	16.9	20.4	21.0	20.3	17.3	12.8	6.6	43.0	19.8
2005	19.1	18.9	20.3	18.4	17.7	17.5	17.1	19.4	22.0	7.4	23.3	20.5
2006	18.1	15.2	23	17.7	16.2	16.0	17.3	16.4	16.8	-0.1	41.3	20.6
Annualised Over												
3 Year	18.5	18.2	19.5	17.7	18.1	18.2	18.2	17.7	17.2	4.6	35.9	20.3
5 Year	15.2	16.8	13.0	15.0	16.7	16.9	17.1	15.4	10.0	5.2	27.2	16.3
10 Year	13.6	14.1	12.9	14.4	13.8	13.9	14.2	14.1	9.2	7.1	17.0	14.5
15 Year	12.0	12.9	10.8	12.8	-	-	-	-	11.7	8.9	17.5	12.8
20 Year	12.0	12.2	11.0	14.6	-	-	-	-	12.1	9.5	14.4	12.1
25 Year	13.3	12.2	10.4	12.9	-	-	-	-	15.1	11.4	15.0	11.5
30 Year	13.0	14.3	11.9	14.7	-	-	-	-	16.5	11.8	18.0	13.0
Standard Deviation:												
5 Year	4.6	2.7	9.3	3.7	2.6	2.8	2.0	3.4	18.6	4.3	18.3	5.6
10 Year	4.3	5.0	6.6	3.5	4.7	5.2	3.9	3.6	16.9	6.9	20.6	4.8
15 Year	6.1	5.8	8.0	5.7	-	-	-	-	15.8	10.2	28.5	5.9
20 Year	9.4	8.0	11.8	9.7	-	-	-	-	15.6	9.3	26.9	9.0
25 Year	8.5	7.1	10.6	9.3	-	-	-	-	15.3	11.8	24.8	8.1
30 Year	8.8	8.3	10.4	10.1	-	-	-	-	15.7	12.9	26.2	8.3

* UBS to 1989

** Source IPD/AREF

*** FTSE/EPRA/NAREIT UK Index - UK REITs Total Return for 2007 (-34.8)