

The Future of Cities

Funding and social capital are key factors in financing regeneration

By Rod Newing

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The global recession has created tight liquidity, stagnating land values and socio-economic strains from heavy corporate restructuring. Many **regeneration projects** may be jeopardised unless new sources of funding can be found.

"As long as cities associate regeneration primarily with social housing and public sector assets, there will be private financing problems," warns Matthew Cutts, head of lenders and investors at EC Harris, a built asset consultancy.

"Banks are asset specific in their selection of where their cash goes. They are currently funding retail supermarkets, healthcare facilities and student accommodation, but the list could change. The problem is finding a lending business case that supports the long-term nature of a regeneration project."

One of the traditional vehicles for financing regeneration has been municipal bonds. Their long-term nature is ideal for big infrastructure projects. Used extensively in the US for many years, they are becoming increasingly popular in developing countries.

"The advantage for the investor is that such bonds may be tax exempt and pay a fixed rate of interest," says Cutts. "To support economic stimulus, the US government has offered federal rebates of up to 35 per cent on the interest costs."

However, there have been defaults on municipal bonds. Mayraj Fahim, adviser on municipal finance at citymayors.com, an international think-tank for urban affairs, says they are a double-edged sword. "You have to use them properly, with strong safeguards, including voter approval," she says. "However, people have been moving towards revenue bonds to avoid that requirement."

There have been big problems with derivatives and variable rates to save interest costs, causing cities with falling tax revenues and rising interest costs to default.

"All they think about is the upside," Fahim warns. "Every derivative has a downside. If they can't afford it, they should not be issuing them. If you have to cut services to make payments, you should not be doing derivatives. It is a time bomb, and many municipalities are going to be in trouble."

She recommends the North Carolina model, where the state government reviews all issues and is conservative about the amount of debt that can be issued. "It makes the weak strong and gives small local government issuers access to capital markets," she says.

Another popular financing method has been tax incremental finance (TIF). This allows a city to fund infrastructure by borrowing against incremental tax revenues generated by the investment. These expected tax revenues service the debt, which is typically over a period of 10-20 years.

However, John Handley, a partner in DPP, a planning consultancy, advises cities to think long and hard before they enter into such a long-term and potentially risky funding arrangement.

"Borrowing against unknown tax revenues is not without its risks," he warns. "If business growth in a TIF area is not as great as first predicted, the local authority will be liable for any shortfall. This would inevitably lead to increases in local taxes, making the area less attractive."

Another source of finance is charitable foundations. They have featured in the regeneration of Pittsburgh, in which Jim Rohr, chief executive of PNC Financial Services Group, has been closely involved for the past 30 years.

He explains that the city benefited from foundation funds from "old money" steel and oil industries. The foundation community worked closely with local businesses to enhance the community and attract new businesses.

One of many projects was the \$90m (£62m) Strategic Investment fund, which provided low-interest mezzanine finance. "The charitable dollars from foundations were leveraged by commercial loans, so we don't end up with a bunch of bankrupt projects," Rohr says.

"We made no bad loans and the fund got its money back with a return. We could have liquidated it, but it has been such an excellent vehicle, we have kept it going."

Peter Latchford, chairman of Urban Living, a 15-year regeneration programme in Birmingham, England, is concerned that standard urban regeneration planning sees the world in terms of capital assets, such as land, roads, houses, schools and hospitals, and frames its investment models accordingly. It judges success by measurable increases in the value of these assets, even if it results from importing the middle classes.

"It often leads to a decline in authenticity, the poorest being displaced and an overall reduction in social capital," he says.

"We should be exploring new models for investing in building 'social glue'. The financial crisis gives the public sector the opportunity to operate with more humility and to understand this critical, organic and human dimension."

He recommends a financial model where asset-backed revenue streams are combined with robust and professional governance; genuine community accountability; an appreciation of the inextricable link between hard and soft interventions; and a long-term perspective.

Tim Johnson, director in development consulting at DTZ, a real estate adviser, emphasises the importance of reducing risk.

"Cities have a long-term stake in regeneration projects," he says. "They must be clear and consistent about what they want to achieve to help minimise risks and make their particular regeneration project more attractive than another."

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