Make an Impact and Generate Returns

CBRE

In 2015, then Chancellor, George Osbourne, told Local Authorities: “grow your area and you’ll grow your revenue too.” Out of necessity, Local Authorities heeded his advice and became more closely engaged with their local economies, adopting new roles and instigating capital projects to deliver socio-economic benefits.

These initiatives include improvements to infrastructure, bringing forward development sites, opening employment land and kick-starting town centre regeneration. Whilst involvement from Local Authorities Pension Schemes in the redevelopment of their local areas is not uncommon, there is growing appetite from them to directly intervene in the delivery of projects and provide funding on a risk-adjusted basis. The reward is the provision of employment and residential space attracting major employers and increased business rates, improvements in local infrastructure, offering energy efficiency, and increasing housing provision alongside appropriate financial returns.

This call to action has been a necessity due to the emergence of a funding gap in commercial development, whereby an unhelpful “chicken and egg” scenario is becoming the norm. Lenders are unwilling to fund schemes without pre-letting, whilst tenants will not commit to pre-letting unless a developer can demonstrate that the scheme is funded.

Tighter banking regulation in the wake of the global financial crisis has limited the availability of debt. Whilst the underlying property market fundamentals in the regions are promising, private sector debt is not there to match this. There is consequently an opportunity in the market for Local Authorities and/or their Pension Schemes to provide development finance where traditional lenders cannot. The use of a local investment initiative can then leverage significant private sector investment at a risk point that maximises participation.

Crucially, such lending can achieve attractive risk adjusted financial returns as well as socio-economic benefits. This does not mean blindly supporting questionable schemes, but rather solving the funding gap and supporting viable projects unfairly side-lined by private sector finance.

Certain Local Authorities and their Pension Schemes have looked to establish carefully managed investment vehicles focussed on local long-term economic growth whilst providing attractive risk-adjusted returns. Dedicated fund vehicles can be established, but funding frameworks where a target amount of capital is kept aside can work just as well. The crucial point is not the legal structure, but rather that there is a clear investment strategy and strong underwriting principles together with a flexible and willing investment framework in place to finance development. Forthcoming pooling of these Pension Schemes offers an exciting possibility of making an impact that still delivers attractive economic returns. The Local Authorities Pension Schemes treat local investment as infrastructure investment that can be held outside the Pools, giving the Schemes even greater flexibility in how they allocate their capital.

A pioneering investment structure for local authorities, and which can be used by their pension funds, is the North-West Evergreen Fund, providing debt funding for development projects in North-West England. CBRE Investment Advisory manages the Fund, developing investment strategy as well as sourcing and managing investments. Now into its second investment round, having outperformed its initial targets, it is considered the market leader in public sector development funding. The original £30m Fund has increased to £105m and is forecast to have enabled assets totalling £1bn in its initial investment round.

This partnership between 16 Local Authorities is the catalyst for the delivery of over £1bn pounds of employment infrastructure and has drawn in significant private sector capital to the schemes it has supported. The Greater Manchester Pension Fund entered into a number of loans once some of the risks had reduced through construction or leasing, but still offered good returns and provided new capital for Evergreen.

A salient example is 125 Deansgate, arguably one of the strongest commercial schemes in central Manchester. In the absence of private sector debt, Evergreen and Merseyside Pension Fund provided a "whole loan," thought to be the first of its kind for a speculative scheme of this size outside of London. The investment provided both the returns the Fund required to continue supporting further regeneration projects and the wider social value for Greater Manchester in the form of Grade A office space in an otherwise undersupplied market. With its £25m Invest to Grow Fund, managed by CBRE Investment Advisory, Basingstoke and Deane Borough Council is one of the first Local Authorities to develop its own local level real estate financing outlet to support development. It will provide finance for a range of commercial property, regeneration and infrastructure projects all aimed at stimulating new jobs, more homes and attracting significant inward investment into the Borough.

Most recently, the Cambridgeshire and Peterborough Combined Authority has appointed CBRE to help set up a Housing and Infrastructure Fund, aimed at delivering 100,000 new homes over the next 20 years.

Crucially, none of these Funds are grants. All are true financial investments expected to see a full recovery of loans to make their financial returns. These pioneering Funds proved to have generated both social and economic returns and have created a blueprint for Local Authorities, Regional Pension Funds and other public sector organisations to follow