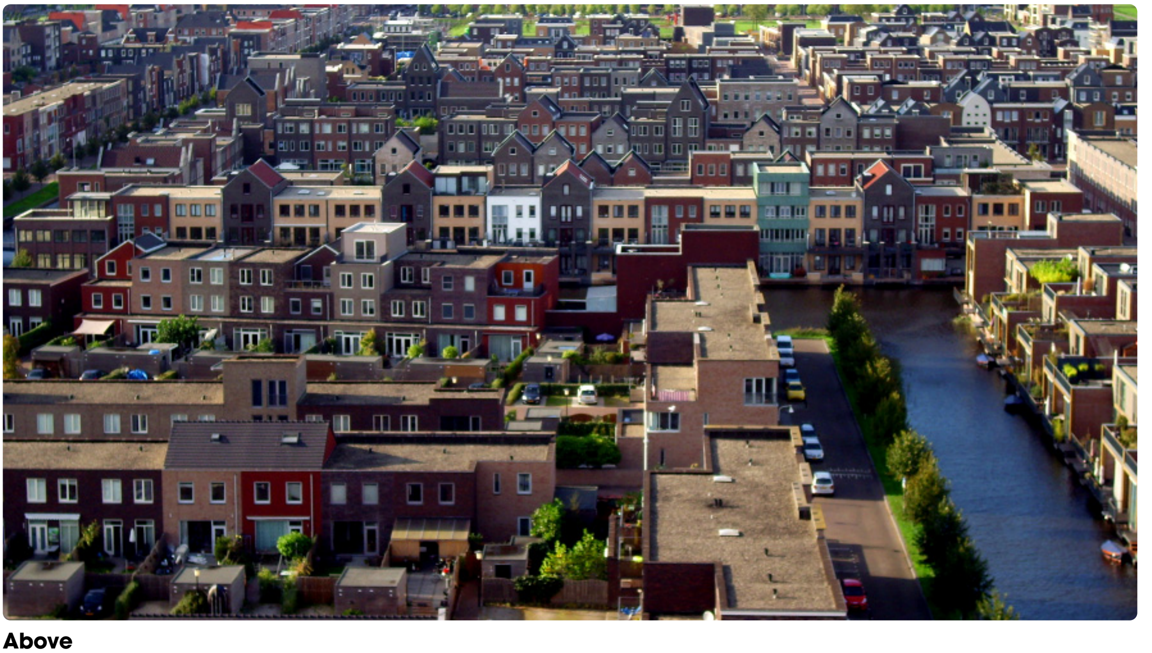
funding large-scale new settlements

Nicholas Falk proposes a way forward in funding the development of large-scale new settlements, drawing on European experience of using state investment banks



Nicholas Falk

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Vathorst in the Netherlands – the development model has enabled high-quality local infrastructure to be built in advance of people moving in

Despite a barrage of articles on the merits of Garden Cities, including the March 2014 special edition of *Town & Country Planning*,[1] surprisingly little has been produced on how to tackle the underlying economic issues of building large new settlements. Letchworth may not provide an ideal model, as it soon ran out of funds, and was later taken over. The New Towns responded to the special circumstances of a post-war Britain, when for a period we believed planning could build utopia. Now that we are once again constrained by austerity, we surely need to be realistic about the scale of investment required, where the funding is going to come from, and what needs to be done to ensure that investors get their money back.

In the March 2014 issue of *Town & Country Planning*, David Lock reminds us that there has been no shortage of visionary plans, and that combined authorities might even agree on the best locations for growth (as in Cambridgeshire). Hugh

Ellis rightly calls for organisations that can overcome local inertia and lack of capacity to deliver the initial investment. But as Peter Hall points out in a recent book,[2] we should also look to Europe for inspiration. Building urban extensions where the infrastructure allows – or 'smarter growth' – is both more intelligent and looks better than scattering small housing estates all over the land. The unresolved question, which the Lyons Housing Review is intended to resolve, is how to break the stranglehold of the volume housebuilders in order to double housing output, something that neither Letchworth Garden City nor the New Towns had to contend with.

How a British Investment Bank would help

The *Beyond Ecotowns* report,[3] which was based on case studies in four European countries, found great similarities in the way that housing was being supplied, with local authorities playing a much more proactive role in the provision of serviced sites. State investment banks made this possible by supplying long-term finance at lower costs than developers would have had to pay. As a result, instead of occupiers having to move into half-finished sites with no amenities or public transport, as is often the case in the UK, developments were completed in a fifth of the time, with infrastructure provided upfront.[4] Private landowners and developers were keen to collaborate, as many of the risks had been removed; and sufficient land was pooled to achieve the scale needed for essential community facilities such as schools, playgrounds, and some basic shops.

'A large part of the continental success in creating attractive new neighbourhoods and keeping housing affordable is due to the role played by state investment banks'

Beyond Ecotowns concluded that a large part of the continental success in creating attractive new neighbourhoods and keeping housing affordable is due to the role played by state investment banks. In Germany there is KfW and its equivalents in the various *Länder* or regions, now focusing on environmental initiatives to address climate change. In the Netherlands there is the BNG Bank, set up by local authorities and central government in 1914. Significantly, BNG is rated along with KfW as one of the two soundest banks in the world by *Global Finance* magazine. In Sweden there is Kommuninvest, now being used a model in the Local Government Association's initiative to set up a Municipal Bonds Agency.

A new pamphlet published by the Smith Institute, *Funding Housing and Local Growth: How a British Investment Bank Could Help*,[5] shows how creating a similar institution to mobilise bond finance for housing and local growth would transform housebuilding in the UK, and also help in upgrading local local transport and energy systems. This would enable the Government to mobilise private finance, as some larger housing associations are already doing in a big way, and hence succeed in doubling output. A new institution should overcome the Treasury's resistance to making funds available on the scale needed.

The British Investment Bank would fund the upfront land assembly, masterplanning and local infrastructure. It would have the skills to decide which projects (and areas) are worth backing, and which are not. It would focus on areas where major transport investment is planned, thus securing full benefits from limited public investment. It would outlive politicians and civil servants and help to rebuild capacity to deliver sustainable urban neighbourhoods and not just housing estates. Its costs would be covered from a margin on issuing bonds to long-term investors for specific areas and projects. Interest on the bonds would be covered through the disposal of sites to a wide variety of builders, including self-builders, and the strength of the proposed British Investment Bank would enable it effectively to underwrite returns.

The availability of a clear source of long-term finance for high-quality schemes should also motivate local authorities to release land for designated growth areas that were agreed with local stakeholders, as is happening in the southern fringe in Cambridge. It would help overcome the problem of developers sitting on land with planning permission by providing an incentive for early action. And it would encourage collaboration across boundaries, as in Oxford, where the city needs to expand into neighbouring areas, to make the most of its economic potential and the public investment going into improved transport links (see Box 1). It might even help to fill the gap in funding social housing: in France Caisse des Dépôts funded 133,000 social housing units in 2011 – as many as the total number of new homes built in the UK last year – and has helped to avoid volatility.

Funding associated infrastructure

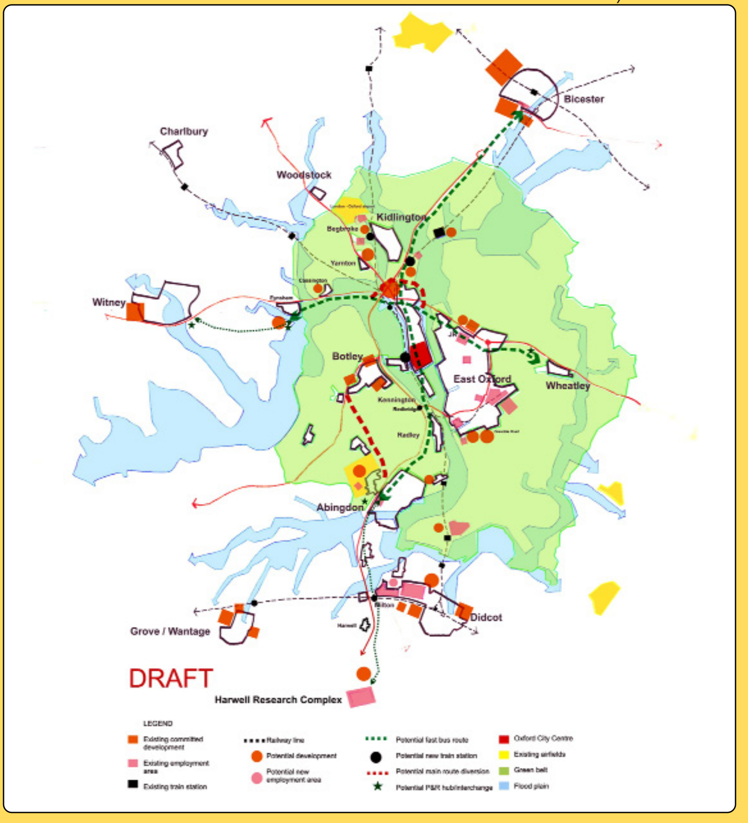
Housing growth depends crucially on local infrastructure, an area in which we in the UK have lagged far behind the rest of Northern Europe. It is the curse of congestion that lies behind much of the opposition to new housing in the southern part of the UK. The failure of supply to match demand has led economists such as Kate Barker to blame the planning system.[6] The LSE's Paul Cheshire goes further in attacking the green belts around our cities

Box 1
Oxford Futures – achieving smarter growth in Central Oxfordshire

The report of a year-long series of consultations on how Oxford might grow[a] recommended concentrating development around the spine of the railway from Didcot to Bicester, which is due to be electrified. By expanding the hub faster than the periphery, and investing in upgraded public transport and cycling, the congestion that usually follows housing growth can be avoided. New Garden Cities on the edge of historic cities where the demand is strong would help to fund associated infrastructure and ensure that it is well utilised. The economic and social benefits would be huge, and in carefully chosen locations the environmental costs can be minimised. The starting point is setting up the organisational mechanisms for strategic planning so that development and infrastructure investment are joined up.

a N. Falk: *Oxford Futures: Achieving Smarter Growth in Central Oxfordshire*. Oxford Civic Society, Mar. 2014. www.oxfordfutures.org.uk/

Plan by Jon Rowland



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Development opportunities in Central Oxfordshire, as set out in *Oxford Futures*

for pushing up the value of housing land, and hence house prices.[7] He compares the value of a hectare of land with planning permission for housing in Oxford – £4 million – with industrial land selling for £1 million in 2011. As he has shown, land values have outpaced house prices, and because there is no holding cost for land they tend to go ever upwards.

But it is the infrastructure that makes a location valuable. At average house prices and densities, land accounts for a third of the price of a typical new house, more if it is detached. As agricultural land often sells for only £10,000 an acre, it is understandable that housing developers spend time securing options on land all around our cities, which they hope to profit from after numerous applications and appeals. With limited supplies and relatively few large housebuilders, it is also easy to see why housebuilders prefer to make sales of around one a week from each active site, and to stick with their standard products, even though only one in four house-buyers considers buying a new home, according to market research by MORI.[8] We are stuck with a fundamentally flawed development system for housing that no amount of tinkering with auctions or loan guarantees will resolve.

The position in the UK is in stark contrast with that in Germany or the Netherlands, both of which have far stronger planning systems but much lower house prices. They are able to build much bigger homes with a higher quality of infrastructure.[9] Some of the explanation lies in different forms of tenure, as a larger private rental sector enables new developments to be occupied faster (rather as has been happening through buy-to-let investors in some parts of London). But the differences are also due to the greater supply of serviced sites with planning permission in locations that are close to motorways, railway stations and rapid transit corridors. Many more housebuilders then compete to meet the needs of a much wider market. With plots being sold as a proportion of the expected sales value, housebuilders compete in terms of

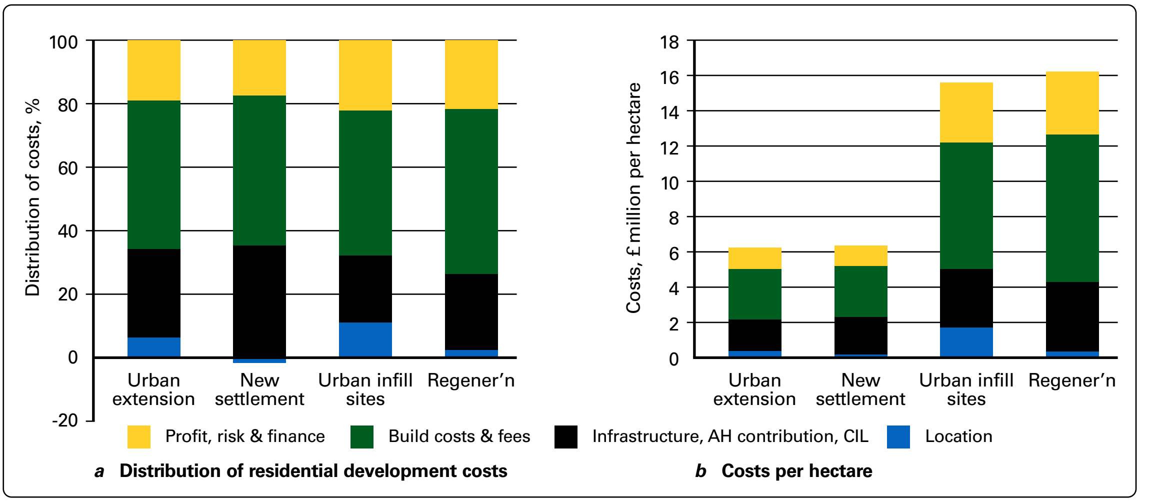

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Fig. 1 Residential development costs by development type
Source: Pete Redman[12]

quality, not price (as happens in Britain). Serviced plots are sold for 25% of the expected sales value or on a sliding scale of between 20% and 30%.[10] Profit levels are lower on individual homes, but probably greater overall, thanks to a steady and predictable level of building.

Planners need to understand the real economics of development (and not be fobbed off with what housebuilders tell them). Research into the cost of infrastructure has found that this can be greater than the new homes cost to build. For example, the new town of Milton Keynes involved an original public investment of £700 million, which allowed it not only to 'start with a park', but also to lay down a grid of kilometre squares. This made it possible for people to drive rapidly to work (but worked against making public transport unviable, as the housing was dispersed). Figures produced for the Homes and Communities Agency found that the 'roof tax' or tariff of £18,500 on each new home will only yield a fifth of the total infrastructure costs.

An analysis of Milton Keynes tariff expenditure showed that transport accounted for a third, followed by schools, and then landscaping, making two-thirds in all. Other factors such as leisure and waste facilities were far less important and could be lumped into a general community charge. A similar analysis by Deloitte for the growth of Cambridge established that the infrastructure cost worked out at £55,000 per new home, of which only a third could be expected to come from the private sector. In this case 57% of the cost was for transport, 14% for health, 12% for utilities, and 10% for education.[11] The programme of infrastructure investment for the period was costed at £4 billion, and the plan was to build 73,000 new homes to increase the housing stock by 40%, far more than anywhere else in the UK.

These two sets of figures are both for areas where most of the development land will be in the form of green fields, usually intensively farmed, and therefore with little biodiversity. A very different set of figures would result from expanding where there already is social infrastructure, and where the scheme can piggy-back on existing roads – for example by building outside a ring-road and making use of an existing park-and-ride scheme, or by upgrading a railway line where there is currently an infrequent service. Such locations would appeal far more to residents than isolated housing estates. Housebuilders welcome building in places where there is evident demand and agreement on both infrastructure plans and the kinds of housing that are required.

The Community Infrastructure Levy plus section 106 contributions are resented by developers because they add to uncertainty or risk, and have to be paid before the value is realised, which is when homes are sold and occupied, and registered with the Valuation Office. As charts produced by Pete Redman, shown in Fig. 1, suggest, building away from existing settlements is wasteful so long as there are sites within easy reach of places where people want to live and work.[12]

A report on economic issues involved in building eco-towns,[4] produced in support of the *Beyond Ecotowns* report, sets out a series of proposals for breaking the barriers in developing exemplary new settlements. These proposals were supported by an action research project funded by the Joseph Rowntree Foundation to share experience between 12 new communities in different parts of England (which informed the building of Derwenthorpe). The

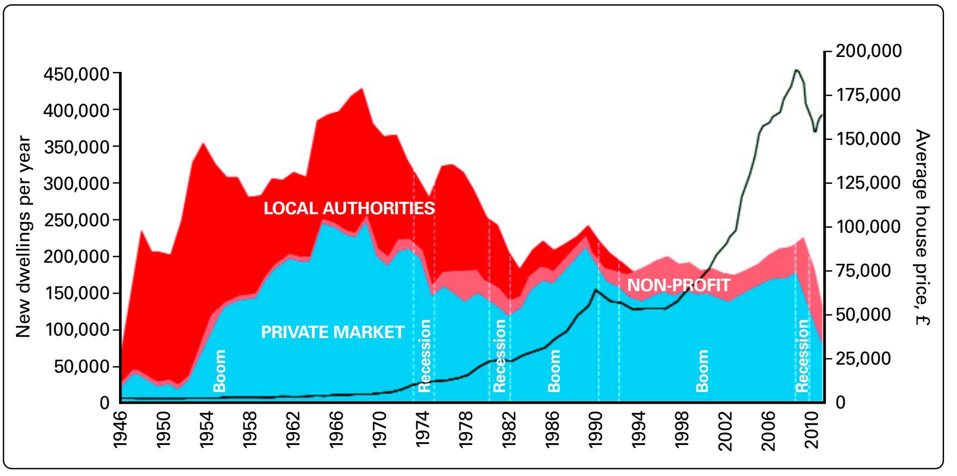

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Fig. 2 Post-war housing supply and average house prices
Source: A. Parvin, D. Saxby, C. Cerulli, T. Schneider: *A Right to Build. The Next Mass-Housebuilding Industry.* University of Sheffield School of Architecture, 2011. http://issuu.com/alastairparvin/docs/2011_07_06_arighttobuild

research also included a short visit to learn from the Dutch approach to building new settlements.[13] The solutions combine strategic spatial planning – deciding what is to be built where – with decisions on funding infrastructure so that development and infrastructure are properly joined up. It requires local authorities to take the lead, not simply respond to proposals from developers.

By raising private funds through a state investment bank, as in the examples of Vathorst in the Netherlands or Rieselfeld in Freiburg, and taking over the land at close to existing use value, developments have been able to fund superb local infrastructure in advance of people moving in – such as district heating schemes and electric trams, which cut energy costs and reduce carbon dioxide emissions, and open spaces that encourage walking and cycling. Money that would have gone to the landowner or consultants in the UK has been invested in infrastructure that adds to the 'common wealth'. In turn, private investors have secured higher returns on their savings.

Controlling land values

Of course, the issue of bonds to pensioners cannot transform the situation on its own so long as land values are so high. It therefore needs to be linked with ways of mobilising land, through tapping into the uplift of land values on designated strategic sites (ones that can yield more than 1,000 units). We must also get land values down if houses are ever to be affordable. For whereas housebuilding has been stuck, house prices have soared, as Fig. 2 graphically shows, and land values have fluctuated even more wildly.

While the challenge of sharing in betterment seems to have defeated the British, continental countries have largely managed to escape house price inflation, and all the problems associated with it. One answer is to copy the Danes, and tax land with planning permission for housing, which is an excellent way of stimulating development (and could form part of long-overdue updating of property taxation). Another method is to adopt the German approach of 'freezing land values' in areas designated for development, which is said to be the real secret of the success in growing cities like Freiburg and its exemplary urban extensions of Vauban and Rieselfeld. The policy would help to simplify a process which would otherwise result in complex and time-consuming negotiations over section 106 agreements or the Community Infrastructure Levy. An explanation by Wulf Daseking, the former Director of Development at Freiburg, of how the system worked is given in Box 2.

Even if land values were greatly reduced, there would still be the problem of incentivising enough activity to double output. A rough estimate of the amount to be raised through bonds, assisted by a British Investment Bank, suggests raising some £10 billion a year, which is significantly less than is required to replace our worn-out infrastructure (costed at £500 billion) but significantly more than the £3 billion allocated to the Green Investment Bank.

This could well be made available if it were secured against land with planning permission for housing, as UK pension funds have very little investment in property, and almost nothing in housing, unlike their continental counterparts. A commitment from central government to make £1-2 billion available each year for affordable housing (as the Homes and Communities Agency has requested) would not only boost private investment, but would also help build

Box 2
German policy for developing unused land

Under German Building Codes 165-171, the urban planning law enables the speedy procurement of unused land. It is used to mobilise land for development and to finance municipal development costs in situations where there is an increasing demand for housing, workspace, or public facilities. The measure is financed from the uplift in land values following development.

The municipality buys land at existing use value, and then sells the land when it has been planned and serviced for the price of undeveloped plots. The difference is used to fund social infrastructure such as schools, parking and green areas, and other costs involved in planning and development. Owners can fend off the purchase if they are willing to carry out development in accordance with the plan, in which case the municipality gets some compensation.

the balanced communities that are needed. Furthermore, it should not have to count against Public Sector Borrowing if we followed European public accounting practice, as cities elsewhere do.

Conclusions

Currently, almost any proposal has to survive an ordeal of criticism because there are no agreed rules for where development should be taking place. By identifying and assessing appropriate sites, and then adopting a charter, as in Cambridgeshire, faster progress could be made and better results for all secured. By pooling land in development sites and capturing the majority of the uplift in values, sensible decisions can be taken on what community benefits to provide, such as affordable housing for local people. By selling off sites to many more small housebuilders, the speed of development can be accelerated through offering greater choice. All this is possible without changing the system. But something must also be done to fix our broken financial system.

Using a British Investment Bank would be the simplest method of breaking all the barriers and building neighbourhoods fit for the 21st century. A British Investment Bank would ensure that good projects get funded, that risks are minimised, and that local authorities do not abuse the promised freedoms they are grudgingly being offered. It would also help give pensioners, and those who manage their savings, the confidence to invest in building new homes, not just in buying existing ones to rent. Combined with a reform of the system for valuing land (perhaps by charging the equivalent of council tax on housing sites in designated growth or regeneration areas so that holding costs reflect opportunity costs), it would help turn visions into reality – and in our lifetimes.

● ***Dr Nicholas Falk*** *is the founder Director of URBED, and co-author with David Rudlin of Sustainable Urban Neighbourhood: Building the 21st Century Home. He worked with Sir Peter Hall on Good Cities, Better Lives: How Europe Discovered the Lost Art of Urbanism. This article is adapted from evidence he gave to the Lyons Housing Review. The views expressed are personal.*

Notes

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13 M. Carley and N. Falk: *How Can Local Government Build Sustainable Urban Neighbourhoods?* Joseph Rowntree Foundation, 2012. www.jrf.org.uk/publications/local-government-sustainable-urban-neighbourhoods