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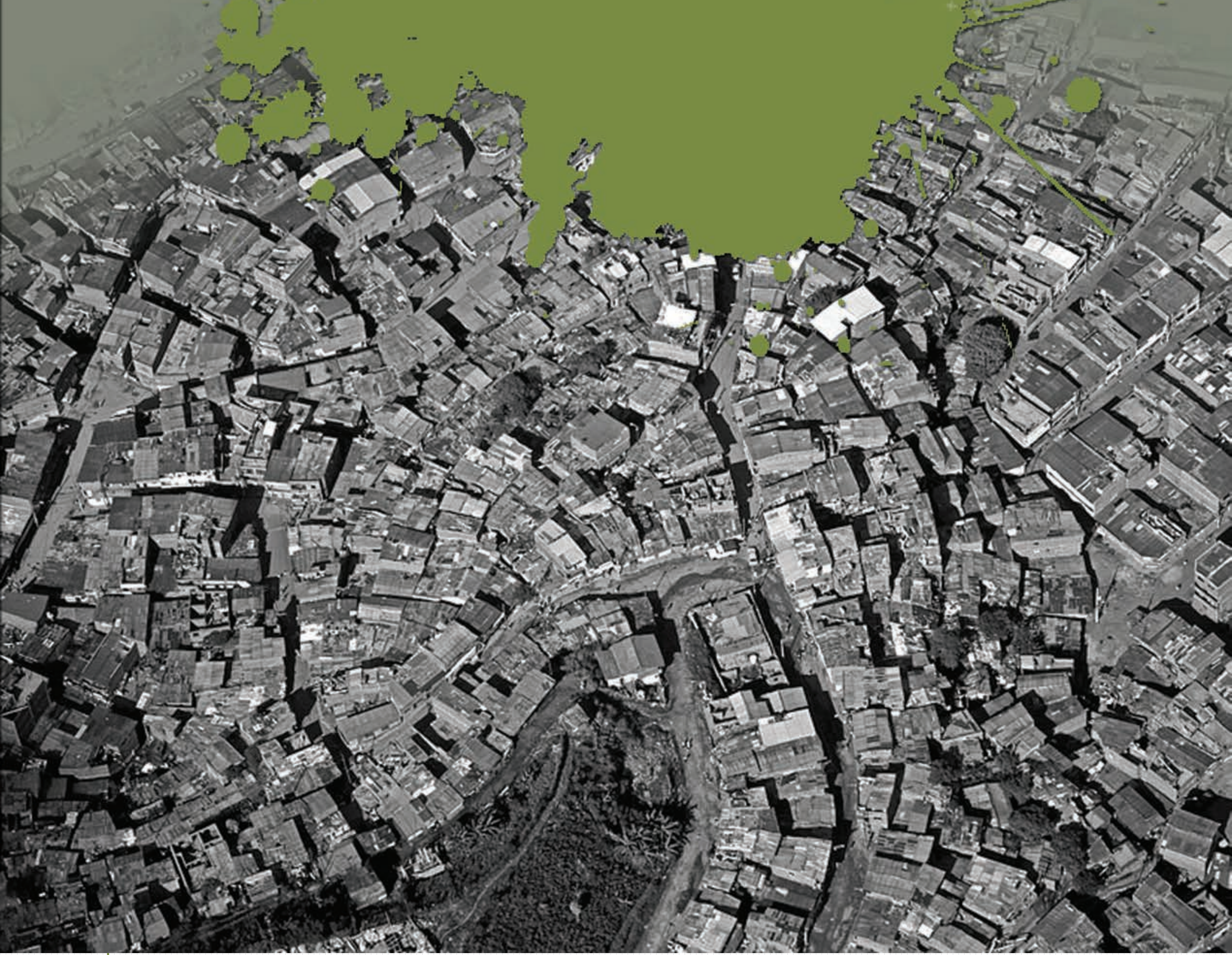

The contribution of a mature real estate market to urban regeneration: What are the prerequisites?

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Abstract

Investment in real estate in terms of housing and space provision for commercial, retail, distribution and industry contributes significantly to the overall economy (GDP, employment, services). The housing sector and the real estate development industry provide significant employment during construction and post-construction (maintenance and management). The existence of a mature real estate market is a prerequisite to effective urban regeneration. But what are the characteristics of a mature real estate market. This paper analyses the role of the real estate market in urban regeneration drawing from comparative research on the UK as a mature market and other emerging markets namely the UAE, Singapore and Malaysia and examining its potential application to Iran.

1. Introduction

The transformation of the world economy with associated technological, social and political change has been rapid over the past two to three decades. Arguably the physical reflection of this change has been most apparent in the transformation that has occurred in the nature, form and function of urban areas (Ratcliffe, 1999). Cities are widely recognised as the drivers of economic growth and are increasingly acquiring significance on the global stage greater than their parent countries. Authors such as Sassen (1994) and Cassells (1991) have considered the characteristics of global centres but even lower ranked cities in the urban hierarchy are increasingly becoming diverse centres with the knowledge-base economy, financial and information services key activities. A fundamental component of these modern city environments is the existence of a vibrant real estate market servicing the needs of occupiers, developers and investors.

In this paper the significance of real estate to the development of cities and the process of urbanisation is explored stressing the linking between competitiveness and well-functioning property markets. This term is then explored in more detail in relation to the characteristics of real estate and its significance within urban regeneration strategies. This is considered in relation to the policies and the mechanisms used in the UK, Ireland and the US.

2. Urbanisation

In examining the growth of cities strong relationships are apparent between urban dynamics, real estate market activities and economic structures (Jones Lang Wootton, 1992). As cities go through different phases of economic activity spanning and industrialisation, growth, congestion, decentralisation, inner city decline and regeneration, real estate activities play different functions. At the immature stage of economic development and urbanisation the most identifiable real estate activity is construction but as economic, cultural and technological interactions become more sophisticated, manufacturing functions decline and the service sector expands to facilitate financial and information processes. In parallel the range and complexity of market activities increase. Although, the interaction between economic development, urbanisation, urban form and real estate product is not necessarily simple, relationships can be hypothesised between the stages of urban development and the advancement of real estate markets. Indeed, real estate economists argue that to understand urban change the constraints imposed by the operation of the property market must be understood (D'Arcy and Keogh, 1997). At the same time there are equally valid arguments that to understand how and why the property market process in individual cities has evolved it is necessary to understand the pressure for economic change.

The competitiveness of cities is facilitated by the existence of vibrant real estate market that facilitates occupier, investor and developer requirements (Berry and McGreal, 1995; 1999). Central to achieving this objective is firstly the ability of cities to formulate and deliver a strategy of long-term relevance to its inherent strength. Secondly, the effectiveness of cities in the management of assets and in coordinating a programme for long-term investment linked to the achievement of an overall vision and plan. Thirdly, division for cities must be capable of translation into a coherent marketing strategy. Arguably, such strategies are necessary to offset disparities between cities and within cities whereby mobile businesses are becoming increasingly concentrated in favourite locations and deprivation is increasing in depressed industrial and inner city areas. Indeed peripheral locations and cities are struggling to attract services on which new economic development will depend. Furthermore, new high quality infrastructure is provided in and between a core group of cities, with the consequences of further concentrating development and investment opportunities.

In a recent report prepared for the RICS Foundation, Gibb et al (2001) consider that competition between cities manifests itself in a number of ways namely competition for investment and population, in the ability to attract private corporate and public sector headquarter offices, competition for public sector funding from central government and competition for major cultural and sporting events. All of these factors are significant targets for urban regeneration strategies and many of these find expression in a property dimension. The determinants of the city competitiveness are considered to include structural variables, the knowledge base skills, economies, agglomeration economies and localised knowledge economies with the land/property market a wider determinant.

The challenge of globalisation for cities has been highlighted by a wealth of publications on this theme during the 1990s (Casstells, 1991; Carnoy et al, 1993; Sassen, 1994, Brotchie et al, 1995; Healey et al, 1995; Newman and Thornley, 1996; Petrella, 1996). Linked to the effects of change is the ability of cities and regions to develop the institutional capabilities to capture global economic flows. Globalisation is seen as creating strategic production centres for the leading economic centres with the attraction of investment flows strongly influenced by the comparative advantage which city markets offer in terms of their relative importance. Locational characteristics offered by urban areas are important with regard to the competition for development, investment and employment opportunities. In these circumstances the institutional regulatory, physical and infrastructural framework offered by urban localities determine the success or otherwise in attracting the free movement of capital and investment into activities most notably real estate (Berry and McGreal, 1995).

Although investment flows occur at a global level, the comparative advantage which city markets and by inference local market offer in term of their relative importance is fundamental. The value of the most real estate is derived from local market conditions with local constraints determining the supply and demand for the property (Worzala and Bernase, 1996). However, market choice can be limited due to institutional constraints including planning policy and procedures with a city's planning system ranging from flexibility to bureaucratic inefficiency. The linkages between occupier, investor and developer markets has been previously referred to in this paper, should one of these be unnecessarily restricted in this case development activity then there are wider implications for the occupier and investor markets. By this I am not advocating an uncontrolled situation, indeed the contrary in that institutional and regulatory systems are also fundamental in producing more sustainable urban development and in achieving renewal of those industrial cities or parts of cities that have gone into decline. In her book Beyond Globalisation, Henderson (1999) argues the need for local governments/city administrations to be proactive in directing bond issues to promote sustainable developments, public transit and renewable energy, the prevention of urban sprawl, facilitating the renewal of inner city cores and the renovation of obsolete waterfronts.

3. Urban renewal and the role of real estate

The need for urban renewal is inextricably linked to the performance and operation of real estate markets. Indeed, urban regeneration arises where real estate markets are fragile, the private sector is cautious about investing and the level of the economic activity as the result in a state of decline (Amin and Thrift, 1995). Traditionally such areas have been considered by the private sector as zones of risks and uncertainty and require some form of public sector intervention to stimulate market activity. The way in which this is delivered and the respective roles of the private and public sectors have been the subject of considerable debate. Mechanisms include direct support to the developer through grant regimes, indirectly through infrastructure provision and environmental improvement, the issuing of bonds or the operation of taxation breaks. However, a common thread has been the emphasis placed upon physical forms of development achieved and the critical role of real estate within this process.

The centrality of real estate within urban renewal and development schemes lies in the unique role of the property as a physical asset/factor of production in providing the facilities and space in which economic functions and their activities are carried out. Likewise, real estate is an investment asset providing returns in terms of capital appreciation and rental growth. The investment performance of property is influenced by local demand-supply side relationships that reflect the vibrancy of the occupier markets. In developing more closely the relationship between real estate development and urban regeneration this paper draws upon experience in the UK, Ireland and the US. The latter two utilises some recent research funded by ESRC on the role of tax incentives in urban regeneration (MaGreal et al, 2001)

3.1. UK perspectives

In terms of a UK perspective issues such as structural change and locational shift has had a major impact on core cities with these effects having become increasingly focused during the 1980s and 1990s. Allied to this is the recognition that, in accordance with sustainability principles, future development is likely to be driven by Brownfield conversion and the re-use of sites. The policy framework for urban regeneration has been set within an area-based focus and has rested largely on the use of statutory and no statutory land use planning initiatives supported by direct public expenditure through various grant regimes and fiscal subsidy in defined geographical areas. This mechanism have been used to offset the perceived weakness of inner city markets, areas that private sector consider as characterised by high risk and low return (Adair et al, 1998).

This area-based approach, which has underpinned UK policy and urban renewal mechanisms, has a distinct emphasis upon delivering physical and economic regeneration with clear outputs into the property market. The policy has been supply-side led with an emphasis upon subsidy through grant regimes, infrastructure and and/or environmental improvements. Central to this policy is the importance given to the real estate development with mechanisms directly supporting the developer and the need to help correct the adverse impact of market forces on deprived urban areas by stimulating of urban land and property markets.

The significance of the regeneration product achieved through area-based mechanisms over a two-decade period (1981-2000) has been analysed by Tyler (2001). This analysis estimates that the public sector spend on the regeneration policy measures has been close to £10bn with a further spend by the private sector and other agencies of over £38bn. The estimated outputs of these processes have been nearly 18,000 ha of land reclaimed, 22 million square meters of floor space, 350,000 net jobs and close to 195,000 new housing units. For the London Docklands, one of the best known regeneration schemes at an international level, close to 2.50 million square meters of floor space, 44,000 net jobs and 24,000 new housing units have been created. The example of London but at a lesser scale has been achieved by many other cities throughout the UK such as Manchester (Salford Quays), Newcastle, Liverpool, Glasgow and Belfast. Clearly on the basis of these statistics the regeneration industry is having a major impact not only on the individual cities but also on the wider macro economy of the United Kingdom.

3.2. The Irish perspective

The Irish situation in particular the case of Dublin contrasts with the UK approach in the use of demand side mechanisms to deliver urban renewal. The use of taxation incentives, in parallel with planning and regulatory measures, to encourage regeneration through property development in the residential and commercial sectors within designated urban renewal areas is the central feature of the Irish model. The tax incentive schemes that commenced in the 1980s where influenced by a number of factors namely increasing environmental awareness, the long-term consequences of urban decline and the reality of the limited financial resources within the public sector (Alen and Whealan, 1991; Adair et al, 1993; 1994). Legislation enacted in the mid 1980s enabled the process of facilitating urban regeneration through fiscal measures applicable within designated renewal areas and targeted at different actor groups.

In terms of output there is a consensus that the tax incentives have stimulated property-based urban renewal, focused developer and investor interest in locations and established new markets that otherwise would not have existed. The International Financial Service Centre in Costum House Docks provides a prime example. It is considered that the incentives have driven up rental values, in particular double rent allowances created the situation whereby property in regeneration areas commanded higher rents than prime areas. Essentially, the higher rent the more could be off set against tax and the higher rents provided the scope for developers to bring forward schemes. A further central feature of this model is the emphasis placed upon end-users rather than developers and particularly those owner-occupiers and residents who bought into the inner city in the early 1990s and kick-started demand.

The experience of Dublin demonstrates that tax-based schemes underpinning urban regeneration require an institutional structure in which to work. To achieve the regeneration of the flagship scheme at Costum House Docks a special purpose authority was established; the full package of benefits under the Urban Renewal Act including 100% capital allowances where available and a special 10% rate of Corporation Tax for the International Financial Services Centre (IFSC). Tax incentives where marketed vigorously with a series of support mechanisms. The creation of an international marketing agency and a IFSC sub-committee was aimed at fast tracking the process and the role of the city authority. Dublin Corporation, as a main land-owner in the inner city, offered sites to the market at a competitive/affordable price. This process was complemented by a highly proactive approach by the Corporation’s Inner City Advisory team marketing the distinct combination of land (to stimulate developer interest) and tax breaks (at occupiers and investors). Dublin Corporation was able to apply conditions in terms of the building permit when they sold land ofr

development, notably in bringing forward residential schemes and achieving wider socio-economic renewal benefits.
Downside of the policy includes problems of dead-weight and displacement. There is recognition that tax incentives as initially applied within Dublin where a blunt instrument and inevitably produced somewhat unpredictable and at time undesirable outcomes but nevertheless where capable of delivering major development and levering investment in the property sector. Displacement effects have arisen from the relocation of financial activities from the city centre and other offices locations to Costum House Docks. However some of these effects where positive and intentional, in centralising activities within an international centre to create critical mass and stimulate business activity by attracting external companies in the financial sector but trading outside of the Irish economy. A key lesson is that tax incentives to stimulate urban development need to be clearly targeted to specific groups in order to be effective. The most efficient way to use tax incentives is to target the end user as this in turn encourages developers to take the initial risk. Investors tend to follow occupiers. Furthermore, the effectiveness of tax incentives was shown to increase where there are complementary supply-side measures (land packaging, infrastructure provision).

3.3. The US perspective

The third example briefly deals with the US experience and in particular the use of tax increment financing (TIF) which as a mechanism demonstrates the use of taxation within the fiscal context. The primary distinction between tax increment financing and the Dublin model is that TIF is not a tax break. Rather it is a mechanism whereby the additional tax increments for a designated area can be used to kick start development by the financing of schemes either upfront or on a pay as you go basis by the use of bonds or other mechanisms. Essentially, the principal focus is on public sector intervention through market mechanisms, an emphasis on private property right and free market outcomes. From purely financial perspective most analyses conducted on TIFs have agreed that the scheme generally works and that tax abatements and financing schemes are perceived as producing net benefits to a city (Klemanski, 1990). Initially TIF was designed to cure blighted areas, redevelop properties and to meet the social and economic needs of the people living in the area. However, TIF in essence has become an incentive programme for developers, who often play competing municipalities off against one another.

In TIF districts there often is a high level of subjectivity as to which projects are funded and which are not. Location is of particular importance in that a TIF is unlikely to work in areas where there is a lack of market pressure. Rigid rules that govern what TIF can be used for, namely rehabilitation of old buildings, write down, public infrastructure improvement, environmental clean up, training and other activities. Objectives have to be realistic in terms of the practicalities of the market place through TIFs have been used to compensate for either declining or stagnating property values. As to whether TIF money is required to finance development depends on the market conditions at the time a TIF district is established and how these market conditions change over time. In this respect the need for TIFs to have clear objectives, to be compatible with market conditions and to be reviewed every 5-10 years is critical.

In Chicago TIFs are almost 100% developer identified and driven. Also TIF has been criticised as mortgaging the future, schemes have proved to be effective in encouraging development. While there are clear and undoubted benefits to developers, the city also achieves regeneration objectives through their use. Moreover, such development often increases other tax increments. The city's bureaucracy is considered to be easy to work with in relation to TIF and while administrative issues may slow down the process, inducement resolution lets project go ahead quickly with the finer detail resolved as the project proceeds. In practice higher profile projects take a longer time to complete but through revaluation of objectives is considered essential on a regular basis particularly in urban areas where the rate of change is greater.

It is apparent that some developments go ahead when, without a TIF funding, they would never have been considered economically viable. There is generally little evidence of dead weight, though it is considered that without TIF good projects would have proceeded but that the scope of development and scale of impact would not have been as comprehensive. TIF is freely acknowledged as being a prime reason for substantial redevelopment and investment coming back into central Chicago to revitalise the core of the city though this placement effects are also apparent for example in the North Loop area.

4. Conclusion

Cities are major drivers of economic growth but need to be competitive to maintain their respective positions within either the global economy or the regional setting. Major structural changes over the past two decades have seen certain cities benefit from locational and agglomeration economies while others and notably inner area locations have suffered decline. As such cities whether perceived to be successful or unsuccessful have had to develop strategies to maintain or re-gain competitiveness. Central to such strategies has been the creation of conditions to facilitate development and investment in the real estate market. Cities in growth regions such as the Pacific Rim, and indeed the major development that has occurred in the United Arab Emirates, have placed considerable emphasis upon real estate and outputs in the property sector. Likewise in mature economies such the UK or US strategies to overcome the downside effects of urbanisation and consequent inner city decline frequently have real estate outputs central to their objectives.

The significance of real estate with development and regeneration strategies lies in the different characteristics of property as a physical asset and as an investment asset. Hence the somewhat unique role of real estate and its importance for users/occupiers, developers and investors. This paper in developing this theme has argued that vibrant real estate markets are fundamental to city competitiveness as the ability to accommodate differing user and investor requirements is a key characteristic of cities within a service sector based economy