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The Credit Crunch and Regeneration: Impact and Implications
An independent report to the Department for Communities and Local Government

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Chapter 1

What is the credit crunch and what has this report done on it?

What we did, how and why

1.1 There has been much successful regeneration across England during the past decade as many urban areas benefited from a buoyant national economy and extensive public expenditure as the *State of the Cities* report\(^1\) clearly demonstrated. But the picture has been changing during the past year as a result of the international credit crunch and economic downturn. This report was commissioned by John Healey, Minister for Local Government at CLG to assess the impact of that credit crunch upon regeneration in England. It attempts to get behind a simplified national picture to find out three things: (i) what has happened to different places, projects and people; (ii) what might happen next and (iii) what are the key implications for all partners involved in regeneration. Regeneration has physical, social and economic dimensions. All are important. But since the credit crunch initially had its impact upon physical development, this study focuses mainly upon that. But other aspects are not ignored. Also although it is a specific phenomenon, the credit crunch cannot be divorced from the wider economy.

1.2 This report answers the following questions:

*What has happened so far?*

1. How has the credit crunch and economic downturn affected different places, projects and people?

2. What actions have different organisations taken to cope with the credit crunch and with what success?

*What might happen next?*

3. Are there any longer term opportunities as well as immediate challenges to regeneration?

4. Are any projects, places and people at a greater risk than others?

*Who should do what about it?*

5. Who, including government, should do what better or differently to reduce risk and stimulate regeneration in future?

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1  *State of the English Cities, ODPM, 2006*
What is the Credit Crunch and what has the report done on it?

1.3 This report has taken the pulse of the regeneration sector. It has collected as many experiences and expectations from as many places and people as possible in a short time. In addition to existing analyses and data, it draws specifically upon:

- personal interviews with over 70 developers; house builders; agents; investors; bankers; employers; regeneration agencies; professional and trade associations; national, regional and local government; voluntary and community organisations;
- workshops with regeneration agencies;
- detailed responses to an e-questionnaire from over 250 public, private and voluntary sector organisations;
- commissioned analyses of the impact of the crunch upon property markets, housing and employment.

1.4 We have had enormous support with this study from many individuals and organisations. Partly this is because of their genuine commitment to regeneration. But partly also it is because of their genuine concerns about the risks to regeneration. Many are concerned about the problems faced by the places, projects and communities they work in and the companies and jobs which have already been lost – and which might be lost in future. Regeneration has had a very good ten years. There are concerns that if regeneration activity is halted now a generation of skills and capacity which has been built upon during the last decade may be lost.

1.5 This report tries neither to exaggerate nor underestimate the risks to regeneration. However, even though the position has been constantly changing in recent months, three things are clear. First, the financial crisis in particular is as severe as anyone can remember. Second, it is not over yet and the pressures on regeneration will get more intense in the coming months. Third, this means that identifying and sticking to some clear principles to guide our behaviour in the future will be even more important. Those principles are not rocket science. Mainly they are those which partners have developed together in the recent good times. Indeed a crucial message from this report is that principles which are good in good times are even better in bad times. Some very clear principles emerge from this study. We outline them here at the beginning as a guide to what follows in this report. It is crucial that partners:

- recognise the threat to – and protect – economically and financially marginal places, projects and people in difficult times;
- recognise that although the market is very difficult much regeneration activity is continuing and must be sustained;
- recognise that regeneration is a long-term challenge which needs long – not short – term commitment;
The Credit Crunch and Regeneration: Impact and Implications

- provide brave leadership and a steady hand in difficult times;
- recognise the threat to the regeneration pipeline and do everything possible to keep the wheels turning and maintain momentum;
- commit to quality, flexibility and innovation in regeneration programmes wherever possible;
- do everything possible now to prepare for the upturn;
- retain existing regeneration capacity and skills wherever possible;
- accept the crucial role of public resources and action in reducing the risks to regeneration.

What is the credit crunch and what caused it?

1.6 This report focuses upon the impact of and implications for regeneration of the credit crunch. In simple terms it means that lenders won’t lend, borrowers can’t borrow, builders can’t build and buyers can’t buy. But this is shorthand for a hugely complex set of issues which have been worsening and changing their shape during the past year. This report does not attempt to provide a detailed analysis of the wider causes of this. However, we do set the scene for our work with a brief review of the nature and origins of the credit crunch. Essentially a credit crunch is a sudden cut in the availability of credit or loans, including mortgages, credit cards and inter-bank lending as banks worry about a lack of liquidity. If the supply of loans reduces significantly, the economic outlook quickly becomes depressed. The credit crunch started as a local phenomenon in a specialised housing market. But it has now gone global and mainstream.

1.7 The credit crunch began in the United States in 2007, when lenders’ exposure to billions of dollars of bad debt mortgages began to spiral. Worries about the viability of sub-prime mortgage lending spread around the financial system, are undermining the ability of banks and building societies to borrow sufficient resources or to feel confident about continuing lending to customers. Across the globe over the past twelve months there has been a chain reaction as it gradually became clear that in a globalised financial system bad risks had spread into many national and international banks with no clarity about where the risks lay. There appears to have been a loss of trust between and amongst banks. As a consequence banks are reluctant to lend to borrowers and more importantly to themselves. The trend began in the property and construction industry which has dramatically affected regeneration. But the reluctance to lend to borrowers and at increasingly high interest rates is spreading more generally into firms and families. The credit crunch had its immediate effects on property markets but has flooded into global banking systems and economies.
What is the Credit Crunch and what has the report done on it?

1.8 Some financial crises – the Stock Market Crash of 1987 – come out of the blue. Others, like the collapse of the dot.com stocks in 2001 are the culmination of pricing bubbles which have been widely, though not universally, expected to burst. The credit crunch clearly belongs in the second category. It has been the product of two factors: inflated house prices, and over-extended credit and leverage in the financial system.

1.9 Inflated house prices and the search for yield in the financial system shared common origins: the equities market collapse of 2001, and the adoption of extremely low interest rates as the main policy tool to stave off economic recession. A loss of confidence in equities while yields on government bonds were extremely low pushed a large flow of capital into “alternative” investments – real estate, private equity, hedge funds and asset backed securities. The resulting rise in value of these assets coupled with very low interest rates made it very attractive to leverage investments with large amounts of debt.

1.10 Mortgage backed securities (MBS) were the point of intersection between rising real estate markets, the search for yield and financial engineering. MBS are a mechanism by which a bank lender converts loans into bonds which are sold to investors. The investors receive the payments of interest and capital due from borrowers, and in the pure form of MBS carry all the risk of non-payment. The originating bank has moved the loan off its balance sheet, and is therefore free to issue more loans. MBS, in principle, spread risk which would otherwise be concentrated in a small number of mortgage originators across a large number of investors. And they were supposed to open up the pricing of lending risk to direct scrutiny by money markets and rating agencies. Large US markets in residential MBS have operated smoothly since the late 1970s and in commercial MBS since the early 1990s. Conditions in the 2000s, however, were an MBS hothouse, which led to a self-reinforcing spiral of rising values and increasing debt. Commercial MBS issuance, for example, quadrupled from 2002 to 2006 in both US and Europe. In residential MBS, the issuance of sub-prime mortgages trebled from 2001 to 2006, while the volume of sub-prime MBS issuance more than quadrupled. In 2006, around 20% of all new mortgages in the US were rated sub-prime.

1.11 The specific sequence of events which led to the present financial crisis was:

- A long rise in US interest rates, from a Fed Funds rate of 1% in mid-2003 to 5.25% in mid-2006 involving no less than 17 successive 0.25% increases, prompted by signs of rising inflation and a desire of Central Banks around the world to drive up long-term real interest rates from historic lows.

- The rise in interest rates checked the growth in US house prices from an annual rate of 20% in the second quarter of 2005 to -4.7% in the final quarter of 2006.

- The combination of rising interest rates and falling house prices exposed the poor quality of sub-prime lending, with a sharp increase in mortgage defaults,
and early estimates that up to perhaps $100 billion of total $605 billion sub-prime MBS could eventually be in default.

- By the end of 2006, mortgage defaults led to a collapse in the value of sub-prime MBS – a halving in value for the lowest quality bonds – which had been widely distributed through the financial system.

- Through the first half of 2007 the fall in mortgage market activity and prices of sub-prime MBS was having a direct effect on those most directly involved in the market – bankruptcy among several US mortgage lenders, with losses and retrenchments among financial institutions at the forefront of dealing and investing in MBS such as HSBC, UBS and GMAC.

1.12 In the late summer of 2007, these problems were still labelled as the sub-prime residential crisis, although the stresses were recognised as severe with potentially serious knock-on effects on the US economy and global financial system. A deepening and broadening into a wider market shock was the product of:

- Plummeting US house prices, where the rate of decline accelerated from an annual rate of -3% in the second quarter of 2007 to -20% at the end of the year, and -25% in the first quarter of 2008, falls which threatened increased defaults across higher grade US mortgages as well as sub-prime.

- The failure of several hedge funds linked to the MBS market, and the first of a long string of losses announced by banks – UBS, Paribas, Goldman Sachs – who had invested heavily in the sub-prime debt.

- A sudden drying up of the inter-bank lending market and leap in inter-bank lending rates due to a loss of confidence that bank losses from sub-prime MBS had been fully declared, and fears that banks would also be affected by further rounds of write-downs on other asset classes – such as corporate bonds and commercial property.

- Write-downs in the values of their assets plus a jump in the costs of their financing via the short-term money markets left banks in a liquidity crisis, which was filled only by Central Banks all around the world extending lines of credit by several hundreds of millions dollars.

- The banking liquidity crisis has forced an ever-lengthening list of enfeebled banks and mortgage lenders into protective mergers, nationalisation or bankruptcy – Countrywide, Fanny Mae and Freddy Mac, Bear Stearns, Lehmans, Merrill Lynch, Northern Rock, Alliance and Leicester, HBOS, Bradford and Bingley.

1.13 The credit crunch has therefore come in two stages. First came the sub-prime crisis, which was a fairly straightforward re-rating of US mortgage debt. Second, came the much wider financial crisis propagated through the pricing of other types of assets, and the impacts on the financing of the banking system. It is the fall in the asset values of the banking system which has triggered the credit crunch. Fear that banks
What is the Credit Crunch and what has the report done on it?

have insufficient capital to meet their obligations simultaneously increases each bank's desire to hold cash and decreases the willingness of all banks to lend to each other. Undermined confidence in capital adequacy has left some banks potentially vulnerable to disastrous runs of withdrawals by depositors, or collapses in share prices, or both.

1.14 Central Banks have attempted to redress the drying up of the interbank lending market by providing cash to the market in exchange for less liquid securities – their on-going lender of last resort role, but on a vastly extended scale. As time has gone by, Central Banks have extended support well beyond the regulated banking system to include monoline insurers, unregulated non-deposit banks, and money-market funds, and Central Banks have been prepared to accept much riskier assets as collateral, including MBS.

1.15 There is much debate about how and why the credit crunch emerged, who is responsible and what should now be done. But there is agreement that the speed with which it unraveled shocked all those involved – bankers, investors, property developers, house builders, governments, regeneration agencies and public organisations. The prospects for regeneration remain uncertain at best. But it is certain that the pressures on the sector will get worse in the coming months before they get better. Nobody in the regeneration sector really knows how long it will last. But nobody believes it will end before 2010.

How does this compare with earlier periods?

1.16 The current downturn and recession in the property market is very difficult. But economic as opposed to financial conditions – so far at least – are not as difficult as those in earlier recessions in the 1970s or 1990s. For example, in the 1990s:

- interest rates were near 14% in contrast to current rates of 1.5%;
- Inflation was over 7% as opposed to current levels of 3%;
- GDP fell by over 3% as opposed to current projections of –1¾ to –¾% in 2009;
- unemployment reached over 10% in contrast to current levels of 6%;
- the main investors were domestic whereas now there is much more international investment;
- nearly 14m sq ft of development was put in the market in 1991 as the economies were in recession, whereas only 7.9m sq ft is expected in 2008-09;
- there had been removal of tax relief on mortgages;
- high interest rates were sustained by the ERM.

1.17 So it is important not to underestimate the economic difference between this period and previous ones. But it is clear the financial position has got increasingly serious
since the original crisis in 2007. A series of bank failures, mergers and bailouts across the globe means that governments across the world individually and collectively are attempting to restore confidence in their national and global banking systems. Stock markets have also tumbled across the world.

1.18 Also despite structural differences with earlier periods, the national economy is slowing down and concerns about the impact of the crunch have filtered into wider concerns about how the performance of the economy may exaggerate the constraints upon development. Simply put, the development and property industries – including the regeneration sector – need end users to buy their products. Once demand drops supply does too. The risk is that the property decline, the financial problems and the economic downturn get thoroughly intertwined.

How is this report organised?

1.19 The rest of this report explores these issues. Chapter 2 focuses upon the impact of the crunch upon commercial property markets. Chapter 3 focuses upon its impact upon housing markets. Chapter 4 explores the impact upon partners and projects. Chapter 5 reports upon the impact of the crunch upon regeneration agencies. Chapter 6 looks at the impact upon particular places. Chapter 7 tries to identify what might happen next. The final Chapter 8 identifies some key policy messages and implications for all partners in the regeneration industry.
Chapter 2

What has been the impact on commercial property?

2.1 The impact of the credit crunch on UK commercial property has to be seen in the context of the recent history of the market. In common with real estate markets in many countries, UK commercial property was a major beneficiary of the flight of capital out of equities in the early 2000s. This drove an unprecedented boom:

- From December 2001 to June 2007, the capital values of commercial property rose by 53%, while rental values rose by only 9%.
- The all property equivalent yield fell every month from March 2002 to May 2007, racking up a cumulative total fall of 2.5%.
- So by mid-2007, the property yield was at an all-time low, and at a 15 year low compared to Government bonds.

2.2 In short, commercial property had experienced a six-year boom with many of the classic signs of being a bubble. The rise in values had been driven by falling yield and only partially supported by a rise in underlying income. Trademarks of an overheated market included very low investment by dominant established investors – domestic institutional funds and property companies – but a very large inflow of money from retail and overseas investors new to the market.

2.3 Through the first half of 2007, it looked like the property market could be heading for a soft landing. Capital growth which ran at an annual rate of 11% through the last quarter of 2006 was already down to 4% by June 2007. In the last quarter of 2007, values fell at an annual rate of -34% – falling far faster even than in the early 1990s.

2.4 The credit crunch which hit the banking system in early August 2007 impacted directly on the property market in three ways:

- Most dramatically, the market for UK commercial MBS closed. Bond issuance was £13 billion in the first half of 2007, but less than £5 billion in the second half, and zero in the first quarter of 2008.
- Bank lending terms on commercial mortgages tightened. A survey of bank lenders suggests bank interest rate margins over swap rates increased by 0.3% in the second half of 2007, while typical loan-to-value (LTV) ratios fell by 4-5%. 
A sharp reduction in the willingness of banks to lend on commercial property. A Bank of England survey shows that lenders have successively tightened the availability of credit for commercial real estate since mid-2007 (Figure 2.1).

**Figure 2.1**

Percentage of lenders reporting tightening of commercial property lending

![Graph showing percentage of lenders reporting tightening of commercial property lending](image)

Source: Bank of England

2.5 By far the quickest route by which the changed terms of bank lending impact upon the market is the apparent reduction in banks’ willingness to extend credit. Anecdotal reports suggest that banks now want to restrict lending to borrowers with whom they have a long-term relationship, or offer only the highest quality credit rating. For buyers accustomed to calculating bid prices and expected returns, or to buying £100 worth of property with £20 of equity, this constitutes a massive change in climate.

2.6 In the current downturn, the process of debt work-out may well be different from what it was in the early 1990s. Then, a concentration of lending on speculative developments and massive increases in interest rates pushed developers into bankruptcy early in the downturn. Forced sales by property companies contributed a lot to the fall in prices. Banks were deleveraging quickly through write-offs of development loans.

2.7 This time round, because most debt takes the form of longer-term lending secured against investment property, there will not be a large wave of developer bankruptcies. So far a few investment funds have been forced sellers because falling values left them in breach of the lending limits. And a few highly leveraged private equity style businesses have gone into liquidation. But for the bulk of borrowers serious stress will arise only when tenants default, or loans come up for refinancing while values remain low.
2.8 Property values fell sharply in the second half of 2007 more because of a shift in sentiment in the market than a change in the terms and availability of credit. That switch can be observed most directly from the flow of money into collective property investment funds (Figure 2.2). The rate of inflow from a combination of institutional and retail investors peaked in September 2006 – when it was running at an annual rate close to 20% of fund values, or £6 billion per year. That flow was down to less than £2 billion per year by June 2007. The credit crunch hit in early August, and the outflow of money from property funds was already running at an annual rate of £0.5 billion by September 2007, and £5 billion by December. As the figure shows, the swing in sentiment among investors was closely matched by the swing from rising to falling returns on property.

Figure 2.2
Inflows to indirect property funds & IPD total returns, % pa

Source: AREF, IPD
Investments in regeneration areas were doing well

2.9 The past decade has been a very good time for cities in the UK as the ‘State of English Cities’ underlined. There is considerable evidence that regeneration areas shared in that improvement. For example, extensive analysis by the Investment Property Databank (IPD) compared the investment performance of properties in deprived areas with those in the rest of England between 1980 and 2001. It showed that property in the 20% most deprived wards on the Index of Multiple Deprivation delivered real returns on investment that compared favourably with non-regeneration areas. Their investment performance over the long run had been close to and, on balance, slightly better than the national average. Property total returns in the regeneration areas averaged 10.7% per year between 1980 and 2001, against 10.2% per year in the remaining 80% areas of England. The trend was found in all three of the main property sectors – retail, office and industrial.

But the credit crunch has already hurt

2.10 But a more recent analysis by IPD has shown that since 2007, property in regeneration areas – defined as the areas which receive current government regeneration programmes – has been more vulnerable to the market downturn than other types of investment property. For example, in 2007 the total return for all property fell by 6.0% in regeneration areas, in comparison with falls of only 3.4% average across the UK. It was easier to get increased capital value in regeneration areas earlier in a property cycle when values were growing from a low base. They coincided with the middle of an economic and investment cycle when funds were freely available, infrastructure and other public investments had already been made, and development and land costs were relatively low. The early stages of a property market downturn may be felt most in regeneration areas where funding, investor confidence and occupier demand would dissipate because the sector was considered more marginal or risky when development costs rise. In IPD’s judgement regeneration property will under perform as long as the property market remains depressed.

But they will eventually come back...

2.11 However, IPD’s view was also that in the long-term there was real potential in regeneration areas. Since returns in those areas were more volatile it was reasonable to expect regeneration property would start outperforming soon after any recovery. For new investors in the sector, it stressed ‘the property market slump is an opportunity for acquisition with prospects of renewed future out-performance. In particular residential properties were a largely untapped source of potential investment enhancement, especially where development is changing the nature of a location and resulting in significant value increase.

2 Ibid
Conclusion

2.12 The credit crunch has already affected commercial property quite seriously as the asset bubble burst. Investments in some regeneration areas have been particularly badly hit. They have performed well recently. Some professionals believe they will perform well again in future. But for the time being and the immediate future the position is difficult. We next look at the way in which the credit crunch has affected housing markets.
Chapter 3

What has been the impact on housing markets?

3.1 The credit crunch has had a major impact upon the housing market which, since the summer of 2007, has undergone a sharp downturn. It was initially induced by the reduced availability of mortgages, caused by the worldwide credit crunch. Additional financial turmoil, growing expectations of house price falls and a slowing economy during 2008 have further helped to depress demand. The unprecedented speed of the decline in the number of house sales indicates the extent of the reversal in market fortunes after one of the longest and strongest upswings on record from the mid-1990s to 2007. The market for new loans has been worst hit. Mortgage loans for house purchase were down 43% in the first six months of 2008 compared to the first half of 2007 (Figure 3.1) and the decline continued over the summer. Land Registry property transaction data were down by a similar magnitude between summer 2007 and 2008. Monthly data were down by even larger volumes when compared to the 2006 peak.

3.2 Some indicators showed that activity may well be bottoming out, although at a very low level. However, renewed problems in world financial markets suggest that the bottom may not have been reached yet.
Figure 3.1:
Number of mortgage loans for purchase and remortgage

3.3 Activity in the housing market actually peaked in 2006 well before the onset of the credit crunch, because affordability was being weakened by rising house prices and mortgage interest rates which discouraged purchase. Prices continued to increase for some time afterwards, however. They would probably have slowed substantially over the past year even without the credit crunch. But the onset of credit crunch has greatly intensified the scale of the downswing. All types of lenders have severely curtailed lending, with specialists falling the most and building societies the least (Figure 3.2).
3.4 Since the onset of the credit crunch, there has been a sharp contraction in new building following a slump in sales, site visits and reservations. Berkeley Homes, for example, reported sales down by 50% in the summer of 2008 compared to a year previously. Housebuilders’ shares have fallen to low levels, though so far none of the majors has folded or been taken over. They have their own financing problems, however, and continue to suffer.

Causes of the downturn

3.5 The extent to which the collapse is due to the credit crunch must be underlined. Between 2000 and 2007, the top ten mortgage lenders’ reliance on customer deposit funding declined from 72% to 55%. By contrast overall gross mortgage lending trebled from £119bn to £364bn. Virtual closure of securitisation markets and limitations on other wholesale sources, such as the high cost of interbank lending, have subsequently greatly restricted the supply of available mortgage funds. Moreover, many lenders have had to increase their own capital bases due to losses on investments and prudent and regulatory pressures in the face of the growing risk of sharp housing market and general economic downturns.
What is the Credit Crunch and what has the report done on it?

3.6 Because of both global and UK specific factors, the credit crunch has not run its course yet. Given continued problems with US residential mortgage-backed securities (RMBS) and other strains in the world financial system, 2009 looks as though it will be a particularly difficult time for the UK housing market.

3.7 The number of mortgage products on offer in the UK dropped from 13,027 in August 2007 to only 3,748 a year later, with average maximum loan-to-value (LTV) ratios falling from 90% to 80%. 100% LTV mortgages have disappeared. Those with poor credit histories have experienced the sharpest rises in mortgage interest rates of 2 to 2.75%, whereas their rates were virtually the same as standard ones the year before.

3.8 There has been a flight to safety in which many potential borrowers are squeezed out altogether until markets settle down again. This is particularly bad news for regeneration areas, which can be perceived as higher risk locations. Such dramatic shifts in lender activity have so far had no appreciable effect on the broad characteristics of borrowers. The average LTV, ages, income multiples and market shares of first-time and existing owner movers remains much as it has been in recent years, so far. There are just far less of them.

Long-run housing market behaviour

3.9 The UK housing market has a long history of booms and slumps, reflecting macroeconomic fluctuations, regulatory and taxation changes, and shifts in mortgage credit conditions. There have been four downturns when real house prices fell nationally over the past forty years. Two were relatively minor – the late 1960s and the early 1980s. Two were substantial – in the mid-1970s and the early 1990s. The majority of other advanced European economies also suffered significant real house price falls (>15%) during the mid-1970s and early 1990s, so the UK situation is by no means unique. Many other European countries are also currently experiencing sharp cut backs in their housing markets as well.

3.10 The two major UK house price downswings in the 1970s and 1990s lasted for four and six years respectively. Both proceeded major general economic recessions and persisted even after general economic conditions improved, particularly in the 1990s. This suggests that, although the current crisis is different, major housing market downswings can have long-lasting damaging impacts on consumer house price expectations, which delay market revivals.
Regional housing market variations

3.11 There is a hierarchy of regional house price levels in England, one that has lasted for many years. London prices are by far the most expensive and then there is a broad decline in prices for regions at further distances from London. This is illustrated in Figure 3.3a, which compares house prices in each English region with those in the South East region. A clear Northern-South divide can be seen throughout the period from 1996 to 2007 (with 'Northern' defined as the Midlands and the Northern regions). London prices spurted ahead in the late 1990s but then fell back again relatively in the early 2000s, only to rise faster again especially in the last years of the boom. The Northern declined relatively until 2002-2003 and then experienced a marked but quite short-lived revival until 2006. Overall, the relative position of the Northern by the end of the boom was much the same as it was relative to the South East at the beginning of it. In the last phase of the long housing market boom, London prices grew the fastest (Figure 3.3b). This may reflect sensitivity to contemporary levels of financial services market activity. The capital’s housing market also experienced a slowdown after the dot.com crash in 2001.

Figure 3.3
a: House prices in English regions relative to those in the South East
What is the Credit Crunch and what has the report done on it?

b: House price changes in selected regions Jan 2006 – June 2008

Buy-to-Let and the private rented sector

3.12 We do not really know whether new-build private properties are purchased by owner occupiers or for investment purposes generally, let alone within urban regeneration areas. However, there is recent evidence that in some areas investors are important buyers. A survey of the new private home market in London found two-thirds of new dwellings were bought by mostly small-scale Buy-to-Let investors. The private rented sector has been important in city centre regeneration areas and to a variable extent in other regeneration areas as well. An obvious inducement for residential investors during the recent boom was expected capital gains, especially as rental income yields had fallen to low levels. But now the prospects for capital gains are much diminished. So, residential investors will probably be less important in future.

3.13 The number of UK households renting privately has grown substantially over the past two decades to reach almost 3 million by 2006, with the number of tenancies expanding by nearly 40% since the early 1990s. There was a surge in the first half of the 1990s, then a slight falling back and further substantial expansion in the ‘Buy-to-Let boom’ from 2002 to 2007. London has by far the largest number of private tenants. Now almost a fifth of London households are private tenants. But other areas of the country have also seen substantial increases in rental property, particularly as affordability problems have grown in the 2000s.
3.14 Buy-to-Let new lending fell back with the onset of the credit crunch but by a somewhat smaller extent than with owner occupation, dropping by a third from the peak in 2007q3 to 2008q2 (Figure 3.4).

**Figure 3.4**
Buy-to-Let lending for house purchase

![Graph showing buy-to-let lending for house purchase](image)

Source: CML

3.15 There has been widespread publicity of new inner city flats being purchased with mortgages taken out using inflated valuations. Ostensibly, these purchases were investments in buy-to-let; whereas in reality they have simply been highly speculative in nature. Much of this sector of the housing market has had little to do with what is normally regarded as rental investment. Such excesses were brought to an end by sharp downturns in the new apartment markets of a number of central city locations in 2006 and 2007. The situation in the affected local housing markets has worsened considerably since then. Such localities now experience some of the largest price falls in the current downturn because of these excesses. The resultant empty properties are highly visible in certain areas of Britain’s cities. However, they represent only a tiny proportion of the overall housing market and are likely to have little effect beyond specific local areas.

**The private rented sector and the credit crunch**

3.16 There are several consequences for the private rented sector of the current problems in mortgage finance.

- *Less investment*. New investment in properties is likely to fall as it is now harder for investors to borrow. This particularly affects new landlords and those wishing to buy in areas where prices are likely to soften the most. Low risk landlords with substantial equity and experience can still borrow.
What is the Credit Crunch and what has the report done on it?

- **Higher demand.** Households unable to fund a planned house purchase or that are less interested in owner occupation when there is a risk of significant price falls raised the demand for rented accommodation. This is being countered by reduced demand induced by economic deceleration, but offsetting recessionary pressures is the continual addition of new households in search of accommodation.

- **Worsening short-term yields.** Rises in rents are being counteracted by falling house prices and higher borrowing costs.

- **Extra supply from owner sellers renting awhile (OSRAs).** When owner occupiers want to move but cannot sell their own property at their reservation prices they may chose to let it for a while rather than accept a more realistic price. A significant number of instructions to let properties from former homeowners have been reported by the Royal Institution of Chartered Surveyors. The overall impact may not be that great, because OSRAs themselves need somewhere to live and, so, are adding to demand somewhere. However, the effect may be significant in some high priced areas such as London when people move to cheaper areas, possibly with the loss of well-paid financial services job. It may also be significant to hard-to-sell localities, including new build in several regeneration localities.

- **Landlords folding because they can no longer finance their investments.** Not all of those buying rental property made wise investments and are finding it difficult to finance their investments. It is difficult to judge the scale of likely repossessions but they are likely to be relatively small in relation to the overall size of the private rented sector – three million dwellings. The impact on the rental market when landlords face repossession is uncertain in any case because lenders when they repossess rental properties may well keep them as such given current market conditions, especially when there is a sitting tenant.

3.17 The overall outcome of these pressures is that a mass sell-off of rental property is unlikely. Many landlords may be hard pressed by rising borrowing costs but a falling market is not a good time to sell and most landlords have sufficient financial cushion to tough it out. Even so, the availability of rental accommodation is still likely to fall, as the surge in supply that occurred during the Buy-to-Let boom from 2004 to 2007 has now passed and fewer will want to buy in a falling market. The relative strength of the rental market, however, should encourage investors to contemplate purchases when they believe that the market has bottomed out.
Housebuilding and land markets

3.18 The new homes market has been severely affected by the credit crunch. Both the net balance of site visits and reservations were around 80% down by mid-summer 2008 on the previous year, according to the Homebuilders Federation. Total UK housing starts in 2q, 2008 were 51% down on the previous year. Many sites have been mothballed, thousands of staff laid off and billions wiped off the value of housebuilders’ shares.

3.19 By international standards, UK per capita housebuilding rates are low. Between 1996 and 2002 private housing starts were actually flat, despite the rapid rise in the house prices over the period (Figure 3.5). Housebuilding rates did improve in the latter years of the boom, with starts a fifth higher in its last three years than they had been around the turn of the century.

Figure 3.5
Housebuilding
a: Private housebuilding 1990q1-2008q2

Source: CLG
b: Private completions as % stock 2003-2007 annual average

3.20 Much of the increase was due to higher housebuilding densities, because the amount of land used for housebuilding actually fell. The fall in land used for housebuilding can be seen in Figure 3.6. Brownfield acreages have been static on a trend basis but there has been a major fall in the amount of greenfield land used, with the area used declining by a half between 1994 and 2005. Regeneration and other brownfield land areas were playing an increasing part in providing new housing supply with brownfield land rising to 75% of all dwellings built in 2007, up from 59% in 1999.
The type as well as the location of housing being built in England changed substantially over the course of the past decade. Higher densities were achieved by greatly increasing the ratio of small flats being built. In the late 1990s, 3-4 bed houses represented 70% of new building; their share had fallen to 47% by 2007, while 1-2 bed flats had risen to 44% of all output, up from only 12% in the late 1990s (Figure 3.7).
What is the Credit Crunch and what has the report done on it?

3.22 The visual impact of these changes can be seen throughout the towns and cities of Britain. Many flats have been built in relatively modest 3-6 storey structures. But a number of iconic high-rise buildings and new residential districts have been built and form one of the most visual expressions of the impact of urban regeneration. In Birmingham, flats have risen from around a quarter of new build in 1997/8 to almost three-quarters in 2006/7. In London, 57% of new housing is located in the East. By 2007, a substantial 140 high rise (12 or more storeys) residential developments were under construction or proposed in the five major cities in Northern England, though many will now no longer be built.

3.23 This pattern of development both suited broader planning and regeneration aims. Rising house prices encouraged younger homeowners in particular to economise on space, which has fitted in with the flat boom. They and the tenants of rental properties were also attracted to the new urban lifestyle on offer, especially as values in the 2002-3 period were shooting ahead and at a time when house prices in the Northern as a whole were beginning to catch up with the boom in the South. Investor interest in purchase was substantial.

3.24 Bubble conditions developed in many of these development markets, as is suggested by price behaviour in the land market. For example, Valuation Office data show a widening gap between the prices of development land for flats and for other types of residential development from 2001 onwards that did not exist in earlier periods. Developer optimism seems to have been greatest in the Northern, Wales and Scotland as well as in London because land prices in those areas increased relative to
those in the South East by much larger amounts than did house prices themselves (Figure 3.8). This convergence may well have been due to the contemporary enthusiasm for large-scale residential urban regeneration projects in the major cities and towns of those areas.

**Figure 3.8**

Relative price of residential land in the regions relative to the South East 2000 & 2008

Note: Graph should be read as NE land worth 29% of SE land in 2000 & 68% of it in 2008, etc. Regions ranked left to right on degree of convergence/divergence with SE values over period.

3.25 Residential land prices throughout England and Wales increased rapidly during the boom years, rising fourfold in real terms from their previous trough in 1993; a much greater increase than for house prices themselves (Figure 3.9). Land prices grew rapidly in the final years of the boom: Jan 2007 prices were at £1.54m per hectare for England and Wales, while the 2000-02 average was only £0.82m. By 2008 land prices were falling equally fast. Savills reported that residential land prices were falling by 20% or more in the first half of 2008, with significant further declines later in the year and more forecast.
What is the Credit Crunch and what has the report done on it?

**Figure 3.9**
Real land prices 1988-2007

England & Wales excluding London at 2005 prices
£000 per hectare for ‘ripe’ serviced land with planning permission

Source: VOA

3.26 The building rates in some Northern cities have been particularly high. If city-wide private housebuilding is measured relative to population size, Manchester, for example, has been building at a rate roughly 50% higher than the national average and Leeds not far behind (Figure 3.10). Supply-side shortages common in many parts of the UK are consequently not so apparent in some of the UK’s regional cities. This is inevitably likely to soften future price growth in these areas.
In the long-term, the supply potential in many Northern cities is substantial. Huge acreages of brownfield land exist and there is strong desire by local authorities to encourage residential development and they permit high densities and high-rise schemes often frowned upon elsewhere. Generally, any upturns in housing demand in such environments are likely to be met by new supply – albeit with a lag that might initially push up prices. The long-run trend in house price growth in such areas, therefore, may be significantly less than elsewhere in Britain where supply-side constraints are far stronger.

Conclusion

This chapter has shown the extent of the impact of the credit crunch upon housing markets in England. It has been extensive across the country. But its impact has been particularly severe in certain kinds of properties – city centre apartments and new buy-to-let properties especially – and in particular places. The next chapters look at how these wider housing and commercial property trends have affected different partners and projects.
Chapter 4

What has been the impact on partners and projects?

4.1 So far we have reviewed the impact of the credit crunch upon commercial property and housing sectors, focusing mainly upon national trends. This gives us an important national picture. However national trends affect different places, projects and people in very different ways. This report tries to get below the national headlines to see what has been happening to regeneration on the ground. The following chapters are based on personal interviews with over 70 key players and the results of an e-survey we received from over 250 individuals and organisations in the regeneration industry across the country. It allows us to see exactly how the crunch has affected them so far and what they think might – and should – happen next. Some had been more badly affected than others. Some were more pessimistic than others. But all emphasised the scale of the impact of the credit crunch so far and its potential long-term damaging impact. We report their views anonymously for two reasons. First, we collected our evidence primarily upon a confidential basis. Second by providing details of current circumstances we do not wish unwittingly to provide any disincentives for future investment in specific organisations or places. The exception is where we discuss London and the wider regional picture. Here the evidence we use is primarily already in the public domain and/or the territorial scale is so great that the risks of identifying individual investment locations is insignificant.

4.2 During the past year there has been a mixed picture. Some schemes and developments are going ahead unaffected. Other developments are slowing down or being delayed. Other sites have been mothballed. Residential developments are extremely difficult. In particular city centre apartments and buy-to-let markets and volume house building have been very badly affected. Commercial property – retail, industrial leisure and mixed use are less pressed (so far). Projects that are already on site will probably finish. Others that are not on site already may or will not start – especially without pre-lets. Nowhere is immune. All places have been affected. Some are better protected than others. But economically and financially marginal places, projects and people are most vulnerable in the flight to quality and the avoidance of risk.

4.3 Our survey of over 250 partners gives us a robust picture of which projects and places have been affected most so far. Over half (57%) reported there had been a reduction of 50% or more in residential-led regeneration activity during the past 12 months. Such reduction levels, although still significant, were somewhat lower in other sectors. The figures were: 41% for mixed use; 33% for office-led development; 22% for retail; 18% for industrial and 20% for leisure-based regeneration activity (Figure 4.1).
4.4 Figure 4.2 shows that partners believe that the economic downturn will have a big impact across all sectors on projects that are – or were – planned to start over the next two years.

What next?

Figure 4.1
Impact of credit crunch on levels of regeneration activity so far

Figure 4.2
Potential impact on future levels of regeneration activity
What is the Credit Crunch and what has the report done on it?

4.5 It is clear that players believe that residential-led developments especially could deteriorate further over the next couple of years. Nearly two-thirds (64%) think that there will be more than a 50% reduction over the next two years (Figure 4.3).

**Figure 4.3**
Impact and potential impact on levels of residential activity

![Bar chart showing impact and potential impact on levels of residential activity](chart)

4.6 Partners expect cuts in activity levels of over 50% in other sectors: 50% for mixed use; 41% for office; 33% for retail; 23% for industrial and 28% for leisure.

The Regional Picture

4.7 No region is immune from the impact of the credit crunch. But the impacts are greater in some parts of the country than others. For example, in the two worst hit sectors, residential and mixed use, partners believe that the Northern and West Midlands regions so far have been more badly hit than Southern and Eastern regions (Figure 4.4).
Which kinds of projects are most affected?

4.8 Our survey gives a lot of detail about the kinds of projects and places which have been most affected.

4.9 Private sector-led residential developments, particularly where there are financially weak developers in place, or developers that have ‘over stretched’ or over exposed themselves are worst affected.

“A number of key developments have halted. Two of these are with a national developer who effectively pulled their south east operations. Another developer has gone into administration leaving one site part developed in the hands of the banks and another site effectively mothballed. In total, original planned housing on these sites of three to four thousand units is on hold...”

[South East District Council]

“Three major private sector mixed use/apartment schemes in the city centre have either been mothballed or abandoned.”

[Northern Core City]

4.10 Areas that have experienced an over-development or over-supply of certain types of residential schemes in recent years are also badly affected. This would include for instance, volume apartment schemes.

4.11 Residential-led regeneration schemes located in less prosperous/peripheral economies, particularly where the majority of potential buyers are those relying on gaining finance through the ‘sub-prime’ mortgage market have been hit. These are
What is the Credit Crunch and what has the report done on it?

now the least attractive schemes to developers. Some Housing Market Renewal Pathfinder (HMMP) and New Deal for Communities (NDC) areas report sites that have been demolished but are now struggling to get developers ‘on board’ to develop housing, placing increasing pressures on regeneration objectives:

“We believe that our area will be more affected by the credit crunch...because there is a high reliance on the sub prime market...we have the sixth highest level of reliance on the sub prime market in the country...”

[Northern Housing Market Renewal Pathfinder]

‘The impact will be felt hardest in the poorest regions where schemes are more marginal...This will result in development opportunities being delayed or permanently lost reinforcing a cycle of decline in the areas hardest hit.’

[Northern Urban Regeneration Company (URC)]

‘Sites in less attractive areas of the city are most affected, which is another pressure on regeneration objectives.’

[Northern Core City]

4.12 Residential-led multi-phase schemes that rely on sales from early phases to cross-subsidise development during subsequent phases have been struggling to progress because of stagnant sales.

“Within our area a number of wider regeneration projects have been delayed due to the credit crunch, where private sales are required to cross subsidise affordable housing and community infrastructure.”

[South West Registered Social Landlord (RSL)]

“A major effect of the credit crunch has been a slow down in sales...sale predictions for the first year has been set at 75. This equates to half the projected number of 144 per annum. The effect will be to delay the launch of later phases...This delay will mean we have insufficient funds available to move out the last of the residents from the later phases. This means they have to live amongst derelict properties for some time, until funding is released.”

[Northern New Deal for Communities area]

Which are affected least by credit crunch?

4.13 Some current regeneration activities and developments are going ahead unaffected. This happens most where there are financially strong developers in place who take long-term views of development. This would include, for example, the £1.2bn Grosvenor mixed use retail scheme in Liverpool which was recently completed and the Piccadilly 1 scheme in Manchester which Argent are leading and in which the
The credit crunch has taken an equity stake. Schemes with contracts in place with most on-site work already completed prior to the credit crunch are also keeping going.

4.14 Schemes led by organisations such as RSLs and regeneration partnerships that secured long-term finance deals at fixed pre-credit crunch rates are able to run developments over the short-medium term using this funding:

“There has been no change to our existing schemes as we already had committed long-term finance in place at fixed [pre-credit crunch] rates.”

[Southern RSL]

“A major housing project has continued unaffected as the finance was already in place before the credit crunch problems hit developments.”

[Northern Regional Development Agency (RDA)]

4.15 Retail and commercial developments which have already secured pre-lets will continue:

“On a major scheme...the developer selection process is currently underway...There was a great deal of interest in this development as there is certainty due to the pre-let nature of the development.”

[Northern RDA]

“Development of major retail project has continued...because the latest phase commenced before the slowdown and is backed by pre-lets, including a [large] department store anchor tenant.”

[Northern Core City]

4.16 Some schemes have ‘tapped into’ areas of prevailing demand. In some predominantly Asian neighbourhoods, RSLs and HMRPs have built family homes using less traditional methods of acquiring finance.

4.17 Sectors that maintained a more sustainable or ‘steady’ approach to regeneration developments during the ‘boom’ have also managed to keep going better.

“We managed to maintain momentum of all its flagship projects. We have not suffered from the massive increase in apartments which...has left other towns and cities vulnerable as a result of over supply. We have maintained steady progress and the residential developments that have been offered to the market have attracted high interest from local people.”

[Northern Borough Council]

4.18 Most PFI funded schemes that do not depend on financial returns and/or are not overly focused on residential-led developments are also progressing. This includes
the development of public sector educational establishments – schools and FE colleges; leisure complexes; hospitals and infrastructure.

“Our ten million pounds Leisure and Neighbourhood Centre is going ahead and on track for two primary reasons. It is publicly financed through NDC and the city council and [secondly] the contractor’s business model includes residential and non-residential development and thus appears to have some buffer against the credit crisis that has affected the residential sector.”

[Midlands NDC]

“Some aspects of regeneration remain strong. Including investment in new health facilities in the borough and the expansion of the local college…Public sector regeneration through renewal of key elements of the borough’s transportation system and schools is also set to continue.”

[Northern Borough Council]

4.19 Developments in more prosperous local economies are still performing well, with some developers now focusing on these areas.

“We are concentrating on smaller prosperous towns which seem more resistant to the downturn.”

[Small national developer]

“We have so far not seen any renegotiated, refinanced or abandoned sites. Work on the town master plan site is still underway with two sites of housing amounting to approximately 800 units still under construction.”

[Midlands District Council]

4.20 Some RSLs’ housing for rent schemes have been continuing largely unaffected as these are not reliant on the sales market.

“There has been no change to our existing schemes as we already had committed long-term finance in place at fixed [pre-credit crunch] rates.”

[South Eastern RSL]

“There are existing rented schemes that remain largely on timetable. We are committed to these and demand is expected to be good…”

[North West RSL]

“There continues to be a huge demand for social rented housing and an increasing demand for intermediate and market rented housing. Schemes that were predicated on a mix that was predominantly rented are largely unaffected.”

[South Eastern RSL]
4.21 No part of the country is immune to the impact of the credit crunch. Projects in all parts of the country are affected. But partners report there has been a flight from risk and a flight to quality – projects, partners and locations. This means that economically and financially marginal places, projects and people are most at risk. So far at least development in London and South East has been less badly affected. It has been better protected by the strength of demand created by the ‘global London’ economy as well as the higher values in development schemes that allow for reduced but continuing profits. However, there is a risk that London and the South East will become more vulnerable because of the scale of jobs in the financial services. Of the big cities outside London those with the more robust, diverse economy will be better protected than others.

4.22 But the particular mix of industrial activities in a place will matter. It is clear that financial services will be vulnerable in the economic recession and places which depend heavily upon them for jobs will be equally vulnerable. This will affect much of the South East but also some places outside which have been very successful in those sectors. By contrast, places which have less private sector and more public employment and which have performed less well, may be better protected in future. In general the smaller towns which are heavily dependent on declining economic sectors – especially in the Northern – are very vulnerable.

‘The impact will be felt hardest in the poorest regions where schemes are more marginal and private sector developer interest more sensitive to changes in the economic and financial climate. This will result in development opportunities being delayed or permanently lost reinforcing a cycle of decline in the areas hardest hit. When confidence returns it will only be for the less risky, more secure, schemes and at a much lower level of value when the markets were at their peak.’

[Chief Executive, Northern URC]

‘Investment is more likely to be focused upon less risky projects in areas where values are higher, perpetuating significant slowdown in activity in areas which are most in need of regeneration. There will be an impact upon quality and sustainability targets because of the need to reduce costs. The areas which are slowest to recover will be the areas where values are lowest. The Northern region will be the weakest with the South East corridor quickest to recover.’

[Chief Executive, Northern Local Authority]

“It will be harder to carry out regeneration in the towns that most need it, as they have the most fragile economies, the least sustainable demand and are generally less attractive to long-term investors...”

[National niche developer]
What are the future risks?

4.23 Many are concerned about the impact of the credit crunch on regeneration so far. But even more are concerned about the future. The threat to the pipeline is the real problem for regeneration. There are cranes in the sky now. There will be less of them in future years. The real risk is the combined loss of momentum, confidence, investment, skills and capacity. Regeneration developments in the pipeline have been delayed as developers re-assess their schemes on timing, gaining pre-lets, re-phasing, delaying residential and cost value engineering.

“There are plenty of cranes around at present but these will be disappearing over the next year. The question is will momentum be maintained or will there be a hiatus whilst confidence and finances are re-built. The danger is, unless some action is taken, that there could be at least two or three years’ hiatus in momentum…”

[Northern URC]

4.24 Developers are finding they can borrow less money for schemes.

‘Twelve months ago developers could secure funding that was secured against 100 per cent of the value of the scheme. Today, fewer funders are in the market and the funders will typically provide 70-80 per cent of the value of the scheme. Whilst current phases are being built out, subsequent phases are being put on hold.’

[Property analysts]

‘New funding margins have quadrupled and finance availability has reduced, putting future new schemes in jeopardy.’

[Southern RSL]

4.25 Partners are also concerned that valuers and valuations have become increasingly conservative compounding the difficulties in borrowing. Appraisals have been badly hit, fuelling an air of scepticism across all sectors, as a combination of increased interest rates, worsening yields, empty rates fears and increasing construction costs all having a noticeable impact on future regeneration schemes.

“The credit crunch has affected development appraisals...that are used to justify the economic viability of a specific project. The surveyors carrying out the appraisals are being cautious as they are hearing from developers that it is currently difficult to secure funds from financial institutions who are being overly cautious in who they lend to and at higher interest rates.”

[Northern RDA]
“Recent appraisals of projects have illustrated a change from a positive value equation for a typical 10,000m² office scheme to a negative value of circa 7 to 9 million. This is a result of yields moving out, rental stagnation, the need to increase offers of incentives, continuing increases of building costs and higher interest charges”

[Northern URC]

4.26 Confirming the messages from this report already it is clear that future residential-led schemes have been hit hardest by delays:

“Many housing-led regeneration schemes in the early stages of development have come to a halt...Projects at the early stages of inception have been affected by the financial overview included within development appraisals.”

[Northern RDA]

“Specific housing-led regeneration projects have been delayed for at least 18 months.”

[Northern RSL]

4.27 When schemes do proceed there will be a variety of challenges to be met. There will be pressures to reduce the numbers of units being built, particularly on residential schemes.

“We have reduced our development growth aspirations by 25 per cent, from 1,000 units to 750 units per year, to take account of uncertainty in values, the reduction in mortgage availability for individual purchasers and also the reduction in funding availability for our sector generally.”

[South Eastern RSL]

4.28 There will be pressures to reduce quality and sustainability standards with developers finding it difficult to meet the costs of raised environmental standards. While some regeneration partnership and RSLs insist quality will not be compromised, others appear less confident.

“We have quality and sustainability standards that have not been reduced to enable developments to be undertaken. These standards will be adhered to in relation to future projects.”

[Northern RDA]

“In discussions with developers they are using the credit crunch to try and reduce our requirements on size and quality.”

[Northern HMRP]
What is the Credit Crunch and what has the report done on it?

“The developer in our HMRP area has made slower progress than anticipated of late and has recently recalculated their costs in light of revised profit margins. This is likely to result in a reduction in the quality of the scheme.”

[Northern Borough Council]

“We are involved in a scheme of 2,500 units that is at the pre-planning stage. The impact of the credit crunch has been profound...The financial viability of the project has been severely affected. The rates charged by banks financing our private sector partners has risen to prohibitive levels...The only way to mitigate some of these impacts will be to seek to reduce costs, which will inevitably lead to some compromise in quality.”

[South Eastern RSL]

4.29 There will be risks to mixed tenure schemes as developers attempt to ‘offload’ unsold private housing on to RSLs. Not all private sector schemes are below RSL standards but many are. Not all RSLs will buy such properties. Some partners believe there is risk that if they do, socially homogenous communities may be created in some places.

“With one development the developer tells us there is no market for apartments and has asked the partner RSL to buy them. As we have mixed tenure aspiration of around 25 per cent social renting we are reluctant to allow this, but the spectre of unsold and empty properties is even worse.”

[Northern HMRP]

“Developers are selling market housing to RSLs...The risk is that the net result could be mono-tenure estates...[this is] not very sustainable in the long run.”

[South Eastern Borough Council]

4.30 There will be pressures to change and renegotiate Section 106 (S106) agreements. Many developers do not feel there is sufficient profit in schemes now to deliver numbers agreed in more optimistic times. Probably there will be many fewer affordable homes built by the private sector in future through this method than has been the case in recent years.

“Prospects for affordable housing supply through Section 106 agreements look gloomy...We’re assuming no growth in OMVs for the next five years as a standard financial assumption.”

[National RSL]

“A mixed tenure regeneration project has been completely reassessed by the developer and all of the social housing removed plus the potential receipt has virtually disappeared.”

[Northern RSL]
There will be delays to office and commercial schemes that do not have sufficient pre-lets in place.

“Office schemes...without a pre-let have been delayed mainly because of the unwillingness of financial institutions to lend without significant pre-lets. There are three city centre schemes totalling 265,000 square feet net, which fall into this category.”

[Northern URC]

Some schemes will simply be abandoned; especially those that were deemed more ‘marginal’ even during ‘boom’ times. A number of apartment schemes have also been abandoned or postponed while alternatives are explored.

“Where schemes include flats for sale, the development has been postponed as an alternative scheme is being considered to replace apartments for sale.”

[National RSL]

There will be re-phasing of schemes – often leading to residential elements being delayed while the other elements (e.g. retail/office) are brought forward. RSL boards will become more conservative in future since they have been affected by the crunch and will develop fewer new schemes.

Who’s doing what about it?

Several regeneration partnerships, RSLs and public sector bodies have taken steps to limit the impact. But most admit that it is too early to know whether they are working.

A number are focusing on strategic land acquisitions rather than new build over the next 12-18 months.

“It’s an opportunity to invest time in planning, feasibility and site assembly work in preparation for an improved economic climate.”

[Northern URC]

Many are providing gap funding to schemes regarded as essential to maintain momentum and economic activity.

Agencies are recalibrating phasing of master plans to bring forward less risky schemes, for example, accelerating commercial development in place of residential.

RSLs are preparing ‘alternative products’, for instance, renting homes to meet the demand of those unable to access the sale or social housing markets.
What is the Credit Crunch and what has the report done on it?

“We have consciously sought to reduce the number of properties for sale that we build and are instead building more homes for mixed tenure rent.”

[South Eastern RSL]

“Other tenure options have been considered to deal with unsold units... including rent to purchase, rent with intent, assured short-holds and intermediate rent...”

[National RSL]

4.39 Some are trying to boost public sector financed development and regeneration, particularly through PFI, to put confidence into the market.

4.40 Partners are increasingly looking into use of shared equity to minimise risk from mortgage bottleneck.

4.41 Many are working closely with key partners, increasing dialogue and maintaining clear communication channels to minimise uncertainty and limit damage.

“It’s important we don’t talk ourselves into a recession...There are still many successful regeneration programmes running.”

[Northern EDC]

Conclusion

4.42 Our conversations with key partners have underlined the speed and scale of the impact so far of the credit crunch upon regeneration. There are significant concerns about its longer term impact. Partners are doing what they can to keep the wheels turning. There are many examples of projects continuing. But they are mainly already in the works with agreed funding and tenants. The future looks challenging.
Chapter 5

What has been the impact on regeneration agencies?

5.1 The last chapter discussed the impact of the crunch upon partners and projects. This chapter focuses particularly on the impact upon specialist regeneration agencies. We explore their experiences at some length because they are at the coalface and the leading regeneration tools of the public sector. We explore their experience in detail because they do face different kinds of challenges and as ever the devil is in the detail. We focus upon Housing Market Renewal Pathfinders (HMRPs), Urban Regeneration Companies (URCs), Economic Development Companies (EDCs), New Deal for Communities (NDCs). All have been affected.

The challenge to Housing Market Renewal Pathfinders

5.2 HMRPs are classic regeneration organisations operating primarily in economically challenged areas in the North and Midlands. Trends affecting the wider housing market have also impacted on Pathfinder areas. Their experience is that there were: falling sales and prices especially at the lower end of the market; difficulties for buyers accessing mortgages especially first time buyers and smaller buy-to-let landlords; increased numbers of re-possessions; slow down in development; and falling new build/land values. In some cases, where developers were on site in areas considered to be lower risk and work on existing phases is continuing. In others, work was slowing down or stopping. Many developers were offering incentives to encourage buyers, but this appeared to be having a mixed impact.

5.3 As a result of lower house prices and the credit crunch there are fewer mortgage products, fewer mortgage approvals, fewer potential purchasers and fewer house sale transactions. Private developers are finding it harder to secure sales and are adjusting their offer accordingly. Some have even ‘shut up shop’ for the year. There are two consequences of this for RSLs. On the one hand, there are opportunities for RSLs to purchase additional new homes from developers. On the other, the slowdown of open market homes slows the delivery of affordable housing through planning obligations.

5.4 Most Pathfinder Boards are considering a range of responses including revising programmes and targets; re-phasing developments; sale of properties to RSLs; restructuring development agreements; sharing development risks; and mortgage relief and deposit schemes. Discussions are generally at an early stage and potential solutions are still being worked through.
What is the Credit Crunch and what has the report done on it?

5.5 The section above identified generic challenges in Housing Market Renewal Pathfinder areas. Since even those areas do vary, the next section looks at the impact in specific places across the country.

**Northern HMRP**

5.6 Targets for tenure change and population increase were not being changed although the trajectories for these will change in the short term. The changes to the programme in 2008-09 as a result of the credit crunch are:

- New build numbers have dropped from 150 to 63
- Demolitions have risen from 330 to 400
- Acquisitions have risen from 125 to 140
- Refurbishments have risen from 800 to 900
- An extra 0.49 ha of land that will now be acquired.

5.7 The Pathfinder was trying to keep major schemes moving and starting. It was likely to focus on ensuring the delivery of new homes and tenure diversification in our priority areas/sites and the possible postponement of sites which are less strategically significant until the market is more confident. Rather than full re-negotiation, there was likely to be joint-working to still deliver new homes, but perhaps take advantage of the opportunity to provide new products that meet peoples’ needs and pockets.

5.8 As well as first time buyers, marginal existing owners are also at risk in the current market. Although discussions with lenders locally suggest that possessions and the need for mortgage rescue is at much lower levels than in the 1990s, the Councils/ALMOs have had a significant number of Right-to-Buy purchasers approach them to buy back their home.

**Core City HMRP**

5.9 The credit crunch has had a significant effect on housing supply across the city. There has been a significant slow-down in the rate of new development; a significant degree of redundancies in the construction sector, and now moving into secondary industries; falling property values; falling property sales.

5.10 The volume of residential planning applications has changed in the city (Figure 5.1).
The Credit Crunch and Regeneration: Impact and Implications

Figure 5.1
Number of planning applications

[Bar chart showing number of planning applications from 1 Jul 2005 to 1 Jan 2008, with a dashed line indicating the credit crunch.]  

5.11 The figure below shows how house prices and the volume of sales have changed in the city (Figure 5.2).

Figure 5.2

[Line graph showing house prices and volume of sales from 1 Jan 2001 to 1 Jan 2008, with a red line indicating the credit crunch.]  

5.12 The credit crunch also has implications for housing conditions and the quality of housing in the city. The city already faces serious challenges with the condition of much of the private sector housing. Potential impacts of the credit crunch include: a reduced equity for residents to borrow against for repairs; potential greater difficulty in accessing loans for repairs; a higher cost of remediation compared with the property value.
What is the Credit Crunch and what has the report done on it?

5.13 There were significant impacts for the city's regeneration agenda. Vulnerable market areas were potentially more exposed to the effects of a falling market. Some of the underlying issues that had been masked by rising prices are emerging again. Levels of empty properties have been declining steadily from a high of 9% to 6.7% currently. There is some evidence of an increase in vacant properties in the vulnerable market areas.

5.14 Developers have become significantly more cautious about progressing developments in vulnerable market areas and are slowing down, and in some cases halting, building. In addition some sites are being deferred until the market becomes more viable. Developers were less adventurous about the type of development they will undertake. The reduced appetite for building apartment accommodation was to some extent welcomed as the city's strategy emphasises a mix of housing. The reduction in demand for apartments also suggests there may be less speculative development especially for buy-to-let or buy-to-leave.

**North Western HMRP**

5.15 The shortage of available credit has led to a slowing down in the housing market. The credit crunch has affected prices, affordability and sales in the Pathfinder area. Prices in the area had been rising and catching up with the region but are now falling. Re-sales have started to slow down in all parts of the Boroughs directly reflecting the slowing down of the housing market.

5.16 The impact of the reduction in potential buyers was not uniform and the better quality schemes were selling better than the rest.

5.17 The Pathfinder will see greater competition and risk in a number of areas:

- Developers will have a greater choice of available sites/development deals.
- Regeneration finance will be stretched to deliver government targets.
- Potential purchasers can not access finance.
- Potential purchasers with access to finance will choose to live elsewhere with a greater choice of available housing available.

**Core City HMRP**

5.18 The credit crunch has had a major effect on new housing supply across the city. There has been: consistent and rapid shut down on sites initially in the city centre but now more widespread; a significant degree of redundancies in the construction sector and now moving into secondary industries; a complete drop off in sales in new property especially in the city centre; falling values of property, again primarily new build, and of some land. There are reports of new properties being offered with 25% discounts but higher in some cases. There appears to be a reluctance to repossess linked to this.
5.19 There is a real fall in confidence across lending and development sectors. Some households cannot get mortgages especially where:

- the applicant is seen as sub-prime – mainly because of limited savings for a deposit;
- the property is in a less secure area or of a non-traditional type;
- the property is being sold through an intermediate product such as shared ownership; and
- the intended after use is buy-to-let.

5.20 The housing market across the two cities remains more fragile and volatile in the autumn of 2008 than at any previous time recently.

- Prices continue to fall.
- Sales have dropped dramatically across the whole area.
- The number of void properties has increased.
- There has been a small increase in auctions compared to August 07-June 08.
- The overall success rate at auction continues to fall in most places.

5.21 However, there were some important potential opportunities that would help deliver long-term goals for the pathfinder. These included: an opportunity to rebalance the housing mix, since the degree of buy-to-let was becoming unsustainable and the apartment market was saturated; more realistic property values; long-term opportunities for companies to acquire sites and establish new ways of working with a real focus on place; opportunities for RSLs who can use their assets to acquire property and land.

*Midlands HMRP*

5.22 The housing market in the area is still declining and is a lot slower than it was in 2007. Sale prices are lower than they have been and asking prices are not being achieved. The cheapest properties are selling best. It is predicted that the housing market will continue to decline over the next 12-18 months.

5.23 City centre and new build properties have suffered most. Demand for them is falling more rapidly than for any other and there is a huge surplus of supply over demand. There has been a sharp increase in the number of repossessions of these properties and the number of people trying to snap them up as bargains has not risen at the same level. The predominant buyers of new builds and city centre properties are first time buyers and investors but the sales are very slow. Most are being sold through substantial discounts and the offer of incentives.
What is the Credit Crunch and what has the report done on it?

5.24 The demand for buy-to-let properties has fallen because of the large deposits required and investors are struggling to make their money back to pay off the mortgage levels. Rent levels have increased because of the increased demand for rental properties as people are not buying in the current market.

Urban Regeneration Companies

5.25 URCs are one of the key regeneration instruments across the country. They are designed to stimulate the markets, especially physical regeneration by bringing in public and private sector partners to deliver long-term regeneration schemes on specific areas based upon long-term Masterplanning. Private sector engagement and confidence is crucial to this model. What has been their experience? We look at several across the country.

North Eastern URC

5.26 The agency had 17 investment projects with a total capital expenditure of £3.75bn driven by global demand for petrochemical and chemical based products, engineering services and logistics, the strengths of the area. Expenditure in the area was booming. But the impact of the credit crunch was important. In two mixed use schemes the residential development was delayed from 2009 to 2010. In another scheme the contractual obligation to start two 80-unit residential units was reduced to one. [Public sector education schemes underpinned three major sites which were unaffected.] Commercial developments with strong pre-let or pre-sale had also continued. There had been over 75% reduction of activity in residential in the area, 25% in offices and none in industrial.

5.27 The URC was recalibrating its Masterplan to postpone residential and bring forward commercial development. It was renegotiating development agreements around compulsory purchase order (CPO obligations on the private sector to carry out over a long timescale to preserve their cash.

Northern EDC

5.28 Because, it had not oversupplied the market, the company had managed to maintain momentum on its flagship projects. It did not have the oversupply of apartments in other places so a steady supply had retained local purchase. One scheme had slipped six months. There was demand for retail space and enquiries for hotel developments. It estimated a 10% reduction in activity in residential and mixed use with no reduction in offices, retail, industrial or leisure in its area.

Core City URC

5.29 The credit crunch has already affected the city. There had been major commercial retail and leisure development in the centre in the past five years. However, the credit crunch had led to some schemes being renegotiated, some not proceeding, particularly residential and some commercial. The commercial office market had
expanded substantially in the last five years so that gap funding was no longer required. But that was changing. Recent appraisals showed that a combination of yields moving out, the need for increased incentives, increased building costs and higher interest charges meant that a typical 10,000 m² scheme, which until recently had a positive evaluation, might now have a negative value of £7-9 m. The impact of the empty rate levy on commercial buildings and the added cost of climate change requirements had costs to what might have already been marginal schemes, leading to pressures to reduce costs. These will affect future potential quality and sustainability.

5.30 However, a number of major regeneration schemes had continued. A huge mixed use retail, residential and leisure development had been able to continue even though costs had risen because the developers had the private resources and could take a long-term view and sustain the quality of the development. It could also offer an incentive to attract occupiers in the short term which would reduce their short-term profits for long-term gain. However, the developers do not think they would start such a development now in the city. A series of public sector-led projects which did not require making a financial return had proceeded.

Core City URC

5.31 In this city the real risk was future momentum. Confidence was the most important factor. It had taken years to build but confidence was declining. There had been a general slowdown in projects before they start on site. Schemes on site were all continuing but there was uncertainty whether they would let or sell. Development finance had become very difficult to find unless there were pre-lets. Even then it was difficult. Appraisals were being badly hit by a combination of higher interest rates, worsening yields, empty rates fears and increasing construction costs. All developers were re-assessing their schemes either in timing, gaining pre-lets, re-phasing, cost value engineering and increasingly looking to the public sector for assistance or increasing grant assistance. Decisions were being put on hold now which will impact in two to three years time. No projects have been entirely abandoned.

5.32 The on-site pipeline for offices was good and the city will have a very comprehensive offer in a year to 18 months time. The danger was that the city had specifically set out to expand that sector and needed a steady pipeline of developments coming on stream. The steady flow could be disrupted in two to three years time, by the current lack of confidence. Office schemes which would have started 9 months ago without a pre-let had been delayed mainly because of the unwillingness of financial institutions to lend without significant pre-lets. Three city centre schemes totalling 265,000 sq ft net fell into this category. Also one office scheme of 1,000,000 sq ft has been put on hold even though it has gap funding. Another of 250,000 sq ft was being re-designed because the appraisal did not now work, even with significant public gap funding. One mixed use scheme was being value engineered and further public funding being sought.
5.33 Office development was continuing. 5,000,000 sq ft of speculative office space was under construction in the city centre because:

- they had been pre-sold to financial institutions;
- it was cheaper to finish them rather than stop work;
- enquiries were still reasonably healthy; and
- there was known demand in the market place.

5.34 Housing was easier. The city does not have the same over-supply of apartments as other major cities. There were plenty of buyers capable of funding their mortgage repayments. But the massive rise in deposits expected from lenders was severely hitting the market. As a result, the rental market in the city centre was buoyant. No schemes were being abandoned but schemes not started on site were on hold. One scheme of 200 apartments recently completed, as a result in the slowdown of sales, had changed from selling the apartments to renting. Activity levels in retail, industrial and leisure developments were down by 25%, mixed use and office by up to 50% and residential by over 50%. It was expected that there would be similar in those sectors in future.

5.35 The city was doing everything to sustain momentum, including increasing gap funding and making strategic acquisitions of land at good prices. It was taking a long-term view that this is a temporary downturn which should not distract from the long-term economic trajectory of the city. The Company was sticking to the good practices and habits it learned in far more difficult times. This credit crunch was not as bad for the city as the 1970s and 1980s. The underlying economy in the city was much stronger and more diverse. The city had dropped back to activity levels of perhaps three years ago. This was not great – but compared with earlier economic crises it was pretty good.

Midlands URC

5.36 This is a similar story of major impact on the residential sector but mixed in others. Residential activity had seen 75% cutbacks. Office and mixed use had experienced 25% cuts. Similar performance was expected in future. Seven residential developments providing up to 2,500 units that had been assembled, cleared, had planning permission and were about to start had all halted. Major mixed use regeneration schemes had been spared because the early ones had beaten the crunch and later ones were still in negotiation.

5.37 The city had not built as many high rise city centre apartments but a number of permissions had been granted and were about to start. The crunch provided an opportunity to consider whether that was the appropriate mix in future or whether a more diverse offer with a greater chance of creating sustainable communities would be better.
New Deal for Communities

5.38 NDCs are neighbourhood and community-based regeneration initiatives with a people as well as a physical development focus. Their focus upon communities and neighbourhoods particularly underlines the human dimension of the impact of the credit crunch upon regeneration.

Midlands NDC

5.39 Again there was mixed news from this organisation. Residential was the most affected. There was great uncertainty about its major housing scheme. The housing-led project with national companies would lead to the demolition of 2,000 homes and the new provision of 3,500 which would increase owner occupation from 18% to 64%. The scheme was financially innovative because the LSVT and City Council were putting in land free as opposed to selling it to private developers. The scheme was ready for planning application. All partners remained committed to the project. But the private sector partners had become concerned about the viability of the scheme based upon sales volumes and values, cash availability, the mortgage market and redundancies. They wanted time to review the position at the beginning of 2009. The prospect was that the original arrangement might not work and the scheme would require extra public money.

5.40 By contrast a £10m Leisure and Neighbourhood Centre had stayed on track for two reasons. The scheme was publicly financed by the NDC and the City Council. The contractor business model involved residential and non residential development and was protected from the credit crunch which had affected the residential sector. The expectation was that residential activity would be cut by up to 75% in future whereas mixed use, offices and retail would probably only have cuts in the region of 25%.

Northern NDC

5.41 Similar impacts upon major housing schemes were being experienced. The NDC, the City Council and a developer were in long-term development relationship from 2007-2022 involving 2,500 new homes in the area. Again there was a similar mix of progress and uncertainty. The first phase of the scheme was continuing but development was slowing and the developer was looking to reduce the number of residential units. A second phase was always more difficult to deliver and the level of public funding for the scheme had to be increased by £4m. The third part of the scheme was being radically revised with demolitions abandoned.

5.42 The credit crunch was affecting the longer-term plans for the NDC. The model rested on the assumption that there would be assets transferred to the community in the succession strategy. These potential assets would be less valuable in future for the community although on the other hand it might be cheaper to acquire that asset base.
What is the Credit Crunch and what has the report done on it?

**Northern NDC**

5.43 The experience of this NDC exemplified the social and community costs of the impact of the credit crunch. It has had a 5-10 year major housing programme in the planning stage for over six years with the demolition of 1,200 units and the creation of 1,500, 90% of which were for sale. In 2001 the area was 80% social housing. The scheme involves substantial education changes with two new schools replacing four existing ones, a community centre, a specialist construction skills and training centre and a PCT resource centre. Demolition had occurred and the sales village had opened. The credit crunch had had two major impacts. There has been a slow down in sales. Many reservations had been made when the scheme was launched in January 2008 but were withdrawn, since they could not get mortgages. It is anticipated that sales in the first year would only be half the target figure. This will slow the launch of later phases and restrict the flow of resources needed to pay for decanting tenants, acquisition and demolition. As a result tenants will have to live in derelict properties until the money is found. The wider concern is that the later phases of the project might not proceed since they are based upon projected land values which might not be realised and the projects may not be undertaken. Residents will have paid a very high price since they may have lost their existing homes in the demolition phase but will not have replacements. Public sector funding might be necessary to avoid those social costs.

5.44 The second direct impact was upon gap funding for the £4m Skills Training Centre. Initially part of the funding would be drawn from the sale of the offices of a local charity for housing. In 2007 the site was valued at £1.25m. But that has now been reduced to £700k. The Centre was due to be complete by January 2009 leaving the challenge of finding the money to pay for the development or to leave it part completed. More generally the NDC did not have HMR status, did not obtain Housing Corporation, RDA or growth point resources, and it had used its budget to subsidise the housing element of the NDC. As a result other regeneration projects like community health, safety and employment projects had to be shelved.

**London Regeneration Partnership**

5.45 This regeneration partnership underlined the nature of challenges faced in the South East. It faced slowdowns and delays rather than abandonment. There was still significant market interest because of the prospects for Crossrail and the Docklands Light Railway. A major commercial scheme involving a major food store was also proceeding. In contrast to areas in the Northern and Midlands, current and anticipated cuts in development across different sectors were nearer to 25% than the much bigger percentages in the Northern and Midlands.

**South Eastern Development Corporation**

5.46 It has had a major impact upon the area. Private sector house building has largely collapsed and house builders were selling sites they had intended to develop.
Marginally viable commercial sites were stopping since such projects either relied on companies which had extensive bank debts, companies were in danger of breaching their banking covenant or companies’ own equity share had been eroded by falling land values.

5.47 However development was going on or being planned where: the project was long-term and would take time to complete; companies had a strong balance sheet, the project was equity rich and required little bank debt or contractual obligations remained. The Corporation was buying housing sites from house builders and entering into joint ventures with RSLs to develop them. It was continuing with essential economic and social infrastructure investment. It was examining any public sector housing projects it could pull forward to fill the private sector gap.

5.48 The prospects for its own projects remained good because of public funding but private sector housing schemes would be affected by drops in values and rising costs. This meant there would be less profitability to be taxed through S106 agreements and developers would struggle to fund the higher levels of eco-home specifications.

Conclusion

5.49 This chapter has shown the different ways in which regeneration agencies have experienced the credit crunch. It confirms the familiar pattern. Residential schemes have been badly hit. Schemes which have not started are vulnerable. But many schemes which have started are continuing. Publicly funded projects are more viable. The next chapter looks more closely at the impact of the credit crunch on different regions, cities, towns and rural areas in England.
Chapter 6

What has been the impact upon places?

6.1 We have so far discussed the impact of the credit crunch upon types of projects, partners and regeneration agencies. We now look at the impact upon different places. First we present a very broad regional picture. We next look at the experience of a number of larger cities. We look at the collective experience of the eight Core Cities. Finally we review the experience of rural communities.

The South East

6.2 The South East’s property and development sector has had a strong period of growth over the last decade with high land values, resulting in many town centre development projects completed. However, there are clear signs now that both the commercial and residential markets have felt the effects of the current economic climate. A recent survey of developers found 30% purchaser fall out and 25% fall in prices achieved over the last six months, land values have dropped by more than 25% possibly as high as 50%. Residential development land values appear to be falling at a sharper rate than the underlying residential market, mirroring patterns in the 1980s early 1990s. The impact on the RDA’s regeneration activity to date was primarily the impact on the value of its assets, which may have dropped by up to 30%. South East house prices fell on average 6.4% in the second quarter of 2008 in comparison with the national figure of 4.7%. Housing completions increased to 37,000 in 2007, with 50% of them being flats. But there are increasing signs that flats are not selling because of oversupply, lack of finance, decline in the buy-to-let market and a lack of first time buyers. Housing starts were down 18.7% in the South East in the first quarter of 2008. The market for new homes and land has effectively come to a halt.

6.3 Some mixed use schemes are continuing where they are mainly focused on sectors other than housing. The economic situation was affecting some major city centre retail and developments because of increased build and material costs, falling values and declining retailer confidence. But the underlying economy and jobs market was still strong with employment rates higher and unemployment rates lower in May 2008 than one year earlier. The initial impact of the economic conditions was clearly felt by the house builders. But the region is starting to see the slow down feed into the commercial sector and retail schemes. Here the combined pressures of the increased cost of raw materials, slowing consumer confidence and retail demand, and changes in the yield of shopping centre schemes are starting to feed through into development activity.
Which schemes are less affected?

6.4 Schemes at an early phase in the development process where land assembly, planning policy context and master planning are still to take place, for example, are not immediately affected by the current climate. In these areas where investment decisions are looking 10-15 years ahead there is less pressure. The slowdown does mean that time and planning can go into the design of these major schemes such as the new growth points, to emerge in time for the next cycle. Similarly transport infrastructure investment appears more resilient as planning/development phases are 10 years and longer.

Which are vulnerable?

6.5 The South East is particularly strong in financial and business services. Insurance services have been the first to experience the effects of reduced liquidity and tighter credit because they are exposed by banks offsetting risks. Difficulties are anticipated amongst professional services associated with the development industry as the slowdown in activity effects related areas such as legal services, estate agents and specialist advisory services.

6.6 A major feature of the South East economy is its close relationship with London. More than 730,000 South East residents are employed in financial services, many of whom work in the City and West End. The sector accounts for more than 1 in 4 jobs in 13 of the 55 Local Authority Districts, particularly residents in Surrey, Hampshire and Oxfordshire. They may be vulnerable to job loss if the downturn continues. A number of the most deprived and largest urban areas in the South East have moved up significantly within the UK competitiveness rankings. But many coastal localities particularly in Kent and East Sussex still score considerably lower than the UK average and may see a slower rate of recovery compared with the rest of the region.

The Midlands

6.7 The region has already been affected by the credit crunch. Housing is badly affected. Mixed use schemes in particular have suffered from the collapse in the housing market, because developers can no longer get the profits in the residential parts which makes the scheme unviable without extra funding. Housing based mixed use schemes and speculative office developments in the city centre have stopped. Commercial has been affected by the economic downturn and speculative developments have been put on hold.

What has kept going?

6.8 A major research and development science park has been unaffected. But this is because it is public sector funded and has long-term high value added knowledge based industries in mind.
What is the Credit Crunch and what has the report done on it?

**What is vulnerable?**

6.9 Sectors which are heavily dependent on steel and energy – for example manufacturing and transport – are vulnerable. Places in the region that depend heavily upon them are hit hardest. In these places market confidence weakens quickest and there will be more slowing down of regeneration activities. Overall the region had seen a 50% drop in activity in housing and offices, a 25% reduction in mixed use and a 10% drop in retail and leisure. Expectations are that in the next two years there could be a 50% reduction in housing and mixed use and a 25% reduction in office and retail, industrial and leisure.

**Any opportunities?**

6.10 Again there were opportunities for the region. The RDA was regarded as crucial in keeping the wheels of the region turning and maintaining confidence. In particular there would be opportunity to buy strategic sites for investment that the private sector had been holding for speculative purposes. It would be needed to support especially vulnerable business in the region.

**The North East**

6.11 The credit crunch has already had a major impact. Many housing-led regeneration schemes had come to a halt. Many housebuilders in the region had reduced their staff. There had been a 50% reduction in activity in residential schemes, by contrast with 25% in mixed use and offices and 10% in leisure and industrial. Apartment share have been most affected since they were primarily first time buyers who could not meet the stringent conditions imposed by financial institutions.

6.12 Projects at an early stage had been affected by the cautious approach adopted by surveyors since it is difficult to predict developer interest for projects and sites. Schemes which had been pre-let or had finance already in place were continuing. Many of the physical regeneration schemes were at earlier stages and it was hoped that an improved market in two years time would make them viable, resisting efforts to reduce quality or sustainability levels. But some schemes had been changed to reduce the apartment and residential accommodation originally planned.

6.13 There is a concern in the region that the Northern will be most affected by the downturn. The downturn did however, offer chances for the public sector to get strategic sites at a lower cost since the private sector was reducing its price levels.

**The North West**

6.14 Despite current economic difficulties the region was better placed than it was in the recession of the 1990s. Inflation rates and unemployment were lower and economic growth was less volatile than then. The region had come through the industrial restructuring of the 90s and was better placed to benefit from growth when economic conditions recover. The key message was after a long period of growth the
downturn was a concern but not a cause for panic. The public and private sectors needed to think and act even more long-term.

6.15 However, the credit crunch had had a significant impact on all aspects of the development industry in the region. Retail had been very hard hit. There were significant concerns about office development in the region and concerns that some development will not go ahead even with gap funding. Few projects across the region were not affected. High commodity prices, increased raw material costs, reduced demand in the economy and financial issues were impacting on many projects. Even those with public money directly funded by government grants faced a degree of risk. Either contractors needed extra financial support to complete a project or there could be delays caused by reductions in the labour force or contractors’ inability to raise finance.

6.16 The region’s forecasting panel initially thought London and the South East might be more exposed to the credit crunch than the North West because of its dependence on financial services. But in recent months views had changed as the downturn has moved beyond the financial crisis into the real economy. The region is forecasting slow down in all sectors with the exception of government and other services. The North West might benefit as a result of being a low cost base. But against that particular places were vulnerable – for example, Chester to cuts in jobs from the banking sector and parts of Lancashire heavily dependent on manufacturing and construction because of rising raw material costs. More generally high food prices, increasing price of credit and the end of fixed term mortgages presented several potential threats to low income families in the North West, with knock on effects for the wider regional economy. There were concerns that there could be cuts to financial and business services since the decisions would be taken by companies with headquarters outside the region.

6.17 There were significant threats to several long planned mixed use developments in several of the region’s medium sized towns. There were concerns in the larger cities about the flow of office provision which might dampen future rents and deter investment. Two major proposed stadia could be affected by the liquidity crisis. More generally all development schemes depending upon cross subsidy from retail or residential had experienced worsening development appraisals. The best guess was that whereas industrial development would be reduced by 25%; residential, office and retail schemes would be reduced by 50%, and office and retail and mixed use would be reduced by 75%.

London

6.18 So far this report has not named individual organisations or places, because the evidence was collected on a confidential basis specifically for this study. However, we do identify London since this next section is based upon a report by the Greater London Authority (GLA) which is already in the public domain. The general view of
What is the Credit Crunch and what has the report done on it?

Partners in this study is that London and the South East have so far been better protected to the impact of the credit crunch by first the level of demand generated by the global London economy and by the high values in land and projects, which meant profits could still be made and development still happen even if margins were cut. But even here some developments have been and are being affected. And concerns about the impact of the downturn in the wider economy and employment have become increasingly important. A study in 2008 noted the credit crunch had already had a major impact upon the city’s property market. The key messages of the study were:

- The crunch was having a major impact upon investment, development and occupational markets;
- Drops in prices and activity levels had already taken place in office residential and retail markets, although not as bad as in previous recessions;
- Its heavy reliance on financial and business services made the central London office market more exposed than other sectors to the crunch; and
- Fall in property markets made policy goals for affordable housing and commercial offices more challenging although transport related schemes would be less affected.

6.19 Office leasing held up well into 2007 but went into decline initially in the City but then in the West End in 2008. The impact on the investment market was immediate and deep. There had been record levels of investment in the first part of 2007 but they fell sharply through the year. For example, in the second quarter of 2007 there was over £6 billion of investment, the majority from overseas purchasers. By 2008 this had dropped to £2 billion. International investors were on the whole doing more investing whereas domestic investors were predominantly selling.

6.20 In principle, the position was not as difficult in London as in previous recessions. For example:

- There was a wider range of investors, especially international than in the 1990s which was dominated by domestic investors;
- Developers had reacted more quickly so oversupply of the market was less pronounced;
- The macro-economic climate was much better than in the 1990s;
- It was expected that retail markets would be better protected;
- Rental levels had not risen as much as the 1980s so the scope for drops was less; and
- There had been more stable levels of investment in retail than in offices.
**What might happen?**

6.21 The study assessed it was difficult to predict the long-term impacts of the credit crunch until its full impact on the wider economy was understood. The overall assessment of the outlook for London was not as difficult as in other cities which had less robust economies than global London. However, development would be affected. Market slowdown and credit crunch would affect regeneration schemes across the city. Developers with schemes on the go would change their tactics from achieving the highest possible price to simply selling stock. Schemes that had not started would be delayed or in some extreme cases mothballed.

6.22 Although unpredictable, developments that might be least affected were:

- Sites close to major transport hubs;
- Well established desirable and prime residential areas because of strong underlying demand; and
- Areas associated with the Olympics because of visibility and the opportunity for developers to promote their offer.

6.23 But already tighter credit, weakening occupational markets and falling capital values meant that some developments had become increasingly unviable. The development pipeline for 2009 and 2010 had been significantly reduced since 2007. Developments at the beginning were much less likely to proceed. The impact would be felt across all of London but would be worse in regeneration areas. The risks were that:

- Marginal developments would not be viable in the current climate;
- Developing on brownfield sites, typically the most marginal of developments will be at risk, especially those with high remediation costs;
- Phased development would become more common as speculative developments became too risky;
- Difficulty in securing funding will make even good development schemes at risk;
- Schemes in non-core locations will be more risky than centrally located ones; and
- Scheme starts will slip.

**Midlands City**

6.24 Projects in the pipeline, especially those funded by the public sector, were continuing. But there were pressures on new schemes. Development in the city had not stopped. Some major sites were continuing even though some elements of the scheme were being rescheduled. A series of major public infrastructure schemes in the city centre will go ahead as planned. And several high profile schemes have been completed in the past year. A significant amount of speculative office development
was continuing. Private residential was under pressure but affordable housing was better protected, partly because of Housing Corporation finance. Also some developers were renegotiating schemes and bringing in better mixes of affordable housing which would bring valuable family housing to the city. All this emphasised the city's view that there was underlying strength in the economy which combined with recent and current major developments would help it weather the storm.

6.25 However, smaller developments especially outside the city centre were being delayed especially those which were deemed higher risk or more speculative. Development and regeneration there will be harder in future because of the lack of confidence of the private sector, the unwillingness of lenders to lend where there is an element of risk and a reluctance of site owners to recognise the drop in land values.

6.26 Overall planning applications in 2008 were down by 19% on the previous year and fee income down by 27%. The problems were again particularly experienced in residential schemes. Sites with residential permissions were also proceeding more slowly. The City Council’s use of land to leverage development and raise capital receipts had been affected by a reduction in residential land sales, especially for major residential developments opportunities. Major house builders operating in the city had placed a moratorium on acquiring new development opportunities beyond existing contracts. In some cases this had led to a reduction in competition and lower quality and lower value bids and the local authority had decided not to sell land. In some cases the local authority was having to give land free to developers or postponing payment. And in some cases developers were attempting to get out of joint venture agreements without paying penalty clauses. The city expected a trend to mothball sites as developers hold land, especially where they bought it at the top of the market. In addition there were concerns that developers were trying to renegotiate their Section 106 agreements which they argued were no longer viable.

Opportunities

6.27 There were some opportunities presented by the downturn. They included the chance:

- to acquire strategic land for large future programmes at reasonable prices. However this was offset by the ability of the council to use its existing assets to lever investment and get capital receipts;

- To develop longer term agreements with the private sector to deliver key priorities for the city, especially where these were supported by public money from the Housing Corporation and, for example, new Growth Points;

- To get increased value for money by renegotiating some contracts with developers; and
Since hard times often push developers to focus on the most viable projects, it is a chance to get better quality more sustainable developments, even if there were less of them.

**Future challenges**

6.28 Despite such opportunities, the city faces large potential challenges caused by the credit crunch. The impact on the city's economy will be extensive. Construction, especially housebuilding business, professional and financial services including conveyancing, banking, and real estates agents will be especially affected. As the impact affects the wider economy retailing, hotels and catering and other leisure services will be more seriously affected. And in all of this, the most deprived areas of the city would be most vulnerable as casual and low skilled employment is often the first to go when the economy declines.

6.29 The city is primarily concerned about the wider long-term impact on the city's development. The credit crunch will affect the city's growth agenda. That depends on attracting the right kind of housing to diversify the housing stock in the east and northern areas of the city. There is a potential risk that the drop in residential land values, together with a drawback in the private sector, would see too much social housing being built, undermining the economic and housing diversification ambitions of the city. A key element of the city's development strategy involves significant leisure developments which could be at risk since such discretionary expenditure is the first to go in economic downturns. There will be impacts upon major development planned in the east of the city, with key risks including: the confidence of owners to invest; a reduction in the equity available in properties to form the basis of borrowing; heightened risk aversion by key financial partners like banks; the credit crunch will lead to increased worklessness.

6.30 There are already significant levels of redundancies in the housing sector ranging from developers to agency staff. This will inevitably have an impact upon a range of professional services including planners, quantity surveyors, lawyers and accountants. Depending how deep the slump is there will be knock on effects in the construction industry, manufacturing and retailing which are the key sectors in which many of the residents of deprived parts of the city are looking for work.

**Northern City**

6.31 The city has had some good economic times in recent years. There has been little increase in unemployment and there are a large number of unfilled vacancies. A number of sectors in the area were reporting strong profitability. Economic growth in the area has been above the national average in recent years. Nevertheless, the city was starting to be affected by the downturn. Companies in the area were experiencing weaker sales and reducing profit forecasts for 2008. There were signs that retail activity was slowing even though footfall in the major retail development was holding up. As with other places housing was showing the greatest challenge.
House prices had fallen by 6% since their peak in 2007. And sales had fallen by 50% from their 2007 peak. The price of retail and office space has fallen, in line with national figures. Finance for commercial development had become more expensive and cost pressures make new speculative development unviable in the short to medium term.

6.32 But it was important not to overstate the downside. The property market had not been overloaded by large amounts of speculative development. Rental returns remained firm. Demand for prime space remained high and retail vacancies in the prime retail area were low in comparison with other retail centres. Good quality schemes with a broad mix of uses and strong tenancy prospects were still attracting funding.

6.33 It was expected that the number of housing starts and completions would fall significantly in 2008. Some schemes were being delayed and developers were asking for existing deals to be renegotiated. There was pressure on the city to reduce land values, to weaken Section 106 agreements and to reduce its ambitions for energy-efficient, high quality housing and to change tenure mix. Developers were approaching RSLs to buy unsold properties but not all were suitable. However, regeneration activity was higher in the city than in many other cities because of a higher proportion of public sector schemes, a lack of over supply and relatively robust demand from end users. But against that, confidence was falling and access to funding was getting more difficult.

6.34 There had been other impacts. Mortgage repossessions increased between 2005 and 2007 from 309 to 730. There had been an increase in repossessions from former right-to-buy properties.

6.35 The city underlined a general point across the country – the need to see the current problems in the longer term and to protect long-term regeneration ambitions. It was working extensively with government, lenders, developers and other public sectors and exploring a series of options including:

- Putting schemes on hold if necessary;
- Agreeing a different tenure mix – exploring the prospects with more houses for rent in the short term or some selective social housing in private sector areas;
- Taking less up-front value from regeneration developments – exploring taking lower initial values but with greater share of future profits and in general working to get more transparent long-term relationships with developers; and
- Bringing forward new sites – exploring the prospects of buying land while it is cheaper to try to bring forward schemes earlier and maintain market momentum.
More generally, the local authority was concerned by, and exploring ways of minimising, the human impact of the credit crunch – potential increased homelessness, debt levels, poverty for vulnerable groups, fuel poverty.

The Core Cities

We now look at the collective impact of the credit crunch collectively upon the local authorities in the eight Core Cities, the largest cities outside London. These have experienced substantial regeneration programmes and funds in recent years. They have also experienced significant renaissance during the past decade. But there is evidence that the credit crunch has already begun to impact upon their performance and prospects. The overall key messages are the following:

- There is a reduction in planning fee income for all cities. Six of the eight are predicting large decreases over 2008-09;
- Numbers of major planning applications have been seriously affected, with all cities showing a pronounced dip and in one case no change;
- Business rates’ summonses between July 07 and July 08 show a marked increase; and
- Summonses for empty properties have shown a marked increase in all but one Core City.

Capital receipts and programmes

There were variations between the Core Cities. But there are some powerful general trends. All the Core Cities were experiencing difficulties getting in capital receipts. Cities were finding deals falling through late in negotiations and developers offering much lower amounts for retail sites especially if commercial sites were better protected. Strategic sites were most affected. Receipts from right-to-buy schemes were lower. All cities anticipated slower sales in future than originally planned and were expecting lower income and rephasing their programmes. Some but not all cities were predicting a growing gap in their three year capital programme typically £25-30m. And most were expecting their capital programme to be rather smaller in future than initially planned. And some schemes were likely to be postponed or abandoned. The credit crunch had also raised the cost of short and long-term borrowing which was beginning to put pressure on revenue budgets and hence services.

Fee income in the first part of the current year was mixed but overall the eight Core Cities were showing a reduction of between 7% and 8%. In the past year seven cities had experienced a reduction in major planning applications of between 1% to 30% and others were down. The position has continued to deteriorate. The majority of cities experienced reductions in major planning applications with reductions varying from 8% to 80%. Six of the eight were anticipating fee income would be between 7% to 40% lower than original targets – from £77k to over £1m. Summonses for non-
payment of business rates are increasing. There have been significant increases in summonses for empty properties in all but one of the Core Cities.

**Rural areas**

6.40 Smaller towns and rural areas have also been affected by the credit crunch. Evidence collected for us by the Commission for Rural Communities has highlighted the current and more important the likely potential impact upon smaller and rural places across the country. Again it is not always easy to disentangle the impact of the credit crunch from the downturn in the economy more generally. But as the two begin to fuse that distinction is becoming increasingly less relevant.

6.41 The credit crunch and higher costs of products and services were exacerbating deep seated challenges of running businesses, securing and maintaining jobs and living in rural areas, rather than creating new challenges. Those reported include the disparity of wages for employees in rural workplaces and commuting residents; need for multi-jobbing to create living wage has become more difficult and more necessary, costs of travel and fuel to premises not on mains; late payments from large to small firms.

6.42 Investment and capital finance into rural businesses had been reduced. Banks’ lending had become tighter and high interest rates had led to fewer businesses expanding. Start-ups are moving out of incubation units to be home-based to reduce costs. Micro businesses are having cash flow problems. People were unwilling to invest in new businesses with the impending recession. Some rural businesses were struggling to access finance for expansion. Some land and property transactions were falling through. Some consumers were having greater difficulty securing mortgages, and smaller businesses are experiencing cash flow problems, with evidence of changes in business and consumer credit and late payments. Several sectors including retail, distribution and tourism, were facing greater challenges from the downturn in finance, spending and rising costs.

6.43 The construction industry had been the hardest hit by the credit crunch. The residential market catering for social housing was having problems with tenants defaulting on their rents. Some found a marked increase in the numbers of homes being repossessed, as have the number of people in arrears. This suggests that repossessions have yet to peak. Despite falling house prices, which were creating some challenges for existing homeowners, the lack of affordable housing was still a major concern for many communities. In many rural areas it was still difficult to attract staff because the lack of affordable housing. This was made worse by difficulties faced by staff failing to obtain mortgages.

6.44 Speculative building development and construction had almost ceased. The market for development land had collapsed reducing its collateral value, though farms in the South East were still being purchased and speculatively split into lots for sale.
near towns. Some property companies were pulling out of land deals for development of housing.

6.45 Rural house prices were falling as steeply as in urban areas. Building sites in rural areas were starting to mothball and the lack of new building would increase the demand for affordable housing. The mismatch between demand and supply could be made worse by the potential evictions of private landlords and reduction in private rented housing. Lending for Housing Associations’ developments had become difficult. Higher interest rates make schemes cost more and this may well make them financially unviable.

There are some silver linings

6.46 This chapter has shown in some detail the experience and expectations of a range of regeneration agencies and places. There is variation in detail. Some places are better prepared and less affected than others. It is not all bad news. Partners have identified some potential benefits of the current slowdown:

- There is opportunity to draw breath;
- There are opportunities for the public sector to acquire land cheaper, where they have the resources;
- There are opportunities to prepare for the future especially the provision of infrastructure;
- There are opportunities to seek long-term developers and developments; and
- There are opportunities to promote more sustainable projects.

Conclusion

6.47 These opportunities are clearly important. Nevertheless, these potential benefits are medium- and long-term in contrast to the costs which are immediate. The chances are that, given the continuing credit freeze and deteriorating national and international economic climate, these costs may increase. It is difficult to make sensible predictions at a time when there has been so much turbulence and there remains so much financial and economic uncertainty. However, the next section tries to look into the future in the light of what we know about previous similar periods.
Chapter 7

What might happen next?

7.1 The credit crunch changes its shape and nature. Whatever happens, the consensus is that there will be constraints upon lending and hence upon regeneration schemes in future. In this section we look at possible impacts upon employment and housing markets.

The impact upon employment in the 1990s recession

7.2 Change in employment and demand in the local economy has significant implications for property development and regeneration. We have looked at the experience of previous economic and property downturns to see which sectors and places suffered most then. And we have tried to identify sectors and places which might be at risk in the future. What does it tell us?

7.3 The last fifty years have seen a number of sharp downturns in UK employment with the falls between 1979 and 1983 (8.9%) and 1990 and 1993 (5.6%) being particularly severe (Figure 7.1). The period 1965 to 1972 also experienced a substantial decline in employment (3.7%) but this was spread over a much longer period than the other two downturns (six years c.f. four and three years for 1979-1983 and 1990-1993 respectively).

Figure 7.1:
Employment in the UK

Source: ONS
7.4 This section concentrates on the geographical pattern of employment falls in the 1990-1993 recession. It focuses on the last downturn mainly because the 1990-1993 recession holds more lessons for the current situation that earlier down-turns. The 1979 to 1983 downturn was steeper but it was, in many ways an older, different style of recession with manufacturing and mining bearing the brunt of the job losses and the Northern regions suffering far more than the south. The 1990-1993 recession, by contrast, saw a much more broadly based fall in employment and much wider geographical repercussions which is, arguably, more relevant to today than earlier down-turns.

7.5 Although large numbers of jobs were lost in some service industries in the early 1990s, as in previous recessions the loss of production industry and construction jobs were still the main contributors to the depth of the recession. This was even true in London despite its relatively small manufacturing sector and considerable job losses in financial services. London also suffered considerably from a loss of public sector jobs between 1990 and 1993. A re-distribution of public sector jobs was a little noted feature of the early 1990s recession. Despite the impact of heavy job losses in production industries, small towns in the Northern and West of England were the least affected part of the country other than Northern Ireland. This was partly because of a lack of exposure to financial sector job losses, but largely because of a substantial cushion from increased public sector employment. Increases in public sector employment also helped to insulate many other parts of the country from the full effects of the recession.

What does this mean for us now?

7.6 The evidence points to the Northern and West of England and, in particular, Northern Ireland experiencing the worst impact so far.

7.7 Figure 7.2 averages the changes in unemployment for the regions and Scotland, Wales and Northern Ireland. It shows unemployment starting to creep up in Northern England but divergent trends in the Midlands with a marked increase in the East Midlands and a fall in the West Midlands. Interestingly, London and the South show little change over the year.
What is the Credit Crunch and what has the report done on it?

Figure 7.2:
Change in the Unemployment Rate – Year to July/August 2008

- Northern Ireland
- East Midlands
- North West
- Yorks and the Humber
- North East
- Wales
- South West
- East of England
- South East
- London
- West Midlands
- Scotland

Source: ONS; average of changes in ILO and Claimant Count measures

7.8 The other pieces of recent data are for house prices. These show falls in all regions except Scotland which, incidentally, also shows the biggest fall in unemployment. As with unemployment, Northern Ireland is most affected while the Northern regions tend to show bigger falls than London and the South. The regional distribution is not altogether surprising given the industrial distribution of employment changes. Over the year to June, employment in production industries was down by 1.5% and employment in construction was down by 0.6%. Employment in all other broad sectors was actually higher than June 2007.

Figure 7.3:
Change in House Prices: Year to August 2008

- Scotland
- Outer Metropolitan
- London
- South West
- North
- Outer South East
- East Anglia
- West Midlands
- North West
- East Midlands
- Yorks and the Humber
- Wales
- Northern Ireland

Source: Nationwide
What are the risks to places?

7.9 What has happened so far does not really tell us much about how events are likely to unfold over the next three years or so. To do this we need to think about either industry specific risk or specific local risks. Industry specific risks are the threats to employment by industry at the national level and what these imply for different localities. Specific local risk is where there is a risk of a place performing worse – or better – than its industry mix suggests.

7.10 Specific local risk can be important but it is much harder to assess. Possible examples of specific local risk this time around on both the upside and downside would include:

- A steeper than average decline in house building in areas that have seen a boom in city centre apartment construction;
- A positive impact on construction in some areas if the new programme of nuclear power station construction starts in the next few years;
- A positive impact on construction in some areas, mostly in London or the South that will benefit from new infrastructure work such as Olympics related work, Victoria Line, East London Line and Docklands Light Railway expansion work and M25 widening;
- A positive impact on retail and hotels and catering in tourist areas (especially central London) which are benefiting from the fall in the value of sterling;
- Threats to jobs in London and benefits elsewhere from any remaining relocations arising from the Lyons review; and
- Consolidation – the current round of financial services acquisitions and mergers will lead to job cuts but it could actually benefit some areas if administrative functions were to be consolidated into a single centre.

Which economic sectors may be vulnerable?

7.11 We speculate about the possible threats to specific economic sectors next before assessing their potential effects upon the economic and employment prospects of particular areas and places.

7.12 The agriculture sector faces no obvious threat and it might even do well out of high food prices.

7.13 Production industries have seen falling employment for a number of years but recent improvements in international competitiveness due to falls in the value of sterling may offer some respite. This is unlikely to mean job gains but it should mean that job losses are less serious than in the early 1990s. There is reason to believe that things will not turn out to be as bad as the early 1990s when there was
What is the Credit Crunch and what has the report done on it?

a fall of 4.9% in 1991 alone. Nonetheless, there are still likely to be employment falls but again, far less serious than in 1990-93.

7.14 Financial services are at the eye of the current storm and a major jobs shake out is certain. Employment fell by 8.5% between 1990 and 1993 and there must be a threat of similar losses this time around. There has, however, already been some shake out of employment which fell by 5.5% between 2002 and 2006 which may mitigate the extent of further falls.

7.15 Although the threat to financial services jobs is nationwide, the industry is now actually more concentrated than in 1990. Even excluding the big three of City, Tower Hamlets and Westminster, the top 50 local authority areas in 1990 accounted for 42.5% of UK employment. By 2006, this had increased to 44.8%. This means that although the effects may be nationwide, they may be concentrated in a relatively small number of areas.

7.16 Business services actually saw employment increases across the last recession and have tended to have had such a high underlying growth rate that they have been considered recession proof. At present, however, there is concern that an increase in the customer-supplier links between financial and business services will lead to job losses in business as well as financial service this time around.

7.17 The public sector has not experienced major job losses and employment continues to rise in the recent statistics. There is some possibility of further re-location of existing jobs and there has to be a possibility of across the board cuts further down the line if action needs to be taken to pull back on public sector borrowing. Nonetheless, areas with large concentrations of public sector jobs are likely to be more stable over the next few years.

7.18 Construction saw big employment falls over 1990-93. All of the indications are that jobs losses will also be severe this time around, not least because of the impact of the housing market collapse on jobs.

Which kind of places may be vulnerable?

7.19 The previous section highlighted industries potentially at risk in the current downturn and potential recession. This section assesses what that might mean for different parts of the country.

7.20 Industrial job losses are likely to be less severe than in the early 1990s largely because of the improvement in competitiveness arising from recent falls in the value of sterling in contrast to the over-valuation problems of the early 1990s. Job losses in financial services and construction, however, are likely to be much more severe than in production industries. Some retail and other service sector jobs also look vulnerable.
7.21 This has implications for the geographical pattern of the downturn. Although there may be job losses in manufacturing and other production industries, they are unlikely to be as severe as in the early 1990s. So there will be less of an impact on the remaining concentrations of industrial jobs which tend to be in the Northern and West of the country and in the East Midlands. Financial sector job losses are, however, likely to have a marked local impact. London will be an obvious casualty from financial services job losses although any downturn will not be as severe as in the early 1990s if there is not a repeat of the public sector job losses experienced then.

7.22 There are also a number of smaller centres which have developed substantial financial services clusters over the past twenty years or so and which could well be exposed to a general shake out of financial services jobs. Many of these are currently considered to be relatively prosperous small economic centres. However, the very financial services job growth that has created much of that prosperity makes them particularly vulnerable to the current downturn.

7.23 We show below some more detail on potential employment implications for different parts of the country. A detailed forecast of employment in all of the local economies is beyond the scope of this report. Instead we try to highlight the recession risks implied by each area’s industrial structure. To do this we use location quotients (LQs) for the industries at risk. Location quotients are measures of relative concentration. A location quotient of more than 1 for any particular industry means that the locality has a bigger share of total employment in that industry than the UK average and vice-versa. Clearly, if a locality has a high location quotient for an industry at risk of heavy job losses it is, itself, likely to be a high risk area.

7.24 Table 7.1 shows the LQs for the 56 Primary Urban Areas identified in the State of the Cities report to government. The “Industry Mix Risk Index” has been calculated by weighting the location quotients together using weights of 0.2, 0.2, 0.4, 0.1 and 0.1 for production industries, construction, financial services, business services and retailing respectively. These are based on an assessment of the industry risks discussed above.

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3 The employment local quotients used here are defined as employment in an industry in a locality as a share of total employment in the locality relative to the equivalent figure for the UK.
What is the Credit Crunch and what has the report done on it?

### Table 7.1:
Location Quotients and the Risk Index – Broad Aggregations

<table>
<thead>
<tr>
<th>Primary Urban Area</th>
<th>Location Quotients (2006)</th>
<th>Industry Mix Risk Index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Production Industries</td>
<td>Construction</td>
</tr>
<tr>
<td>London</td>
<td>0.46</td>
<td>0.73</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>1.06</td>
<td>1.01</td>
</tr>
<tr>
<td>Large Cities in the N&amp;W</td>
<td>1.43</td>
<td>1.00</td>
</tr>
<tr>
<td>Large Cities in the S&amp;E</td>
<td>0.88</td>
<td>0.94</td>
</tr>
<tr>
<td>Small Cities in the N&amp;W</td>
<td>1.32</td>
<td>1.11</td>
</tr>
<tr>
<td>Small Cities in the S&amp;ES</td>
<td>0.97</td>
<td>0.79</td>
</tr>
<tr>
<td>Small towns &amp; rural areas in the N&amp;W</td>
<td>1.34</td>
<td>1.09</td>
</tr>
<tr>
<td>Small towns &amp; rural areas in the S&amp;E</td>
<td>1.11</td>
<td>1.06</td>
</tr>
<tr>
<td>Wales</td>
<td>1.23</td>
<td>1.12</td>
</tr>
<tr>
<td>Scotland</td>
<td>0.86</td>
<td>1.24</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>1.13</td>
<td>1.24</td>
</tr>
</tbody>
</table>

7.25 Not surprisingly, London comes out top in the Industry Mix Risk Index. The areas worth highlighting, however, are both small and large cities in the South and East, the METS2 cities. The first two of these have relatively high risk scores because of their exposure to financial services. The Metropolitan cities score higher than average because of their exposure to production industries, construction and financial services.

7.26 Within London, the central Boroughs are clearly most at risk. The Industry Mix Risk Index for central London on its own would have the value of 1.77 with outer London scoring 0.82. It is sensible to highlight the obvious risks to central London employment. However, the close links between the central and outer-London economics means that outer London will not escape any job losses relatively lightly.
The Potential Economic Impact of the Housing Market Problems

7.27 The current downturn is different from all previous ones because of the strong emphasis on credit availability and the subsequent impact that has had on purchaser and seller price expectations. So, it is hard to predict how long the credit crunch will go on and what the scale of the effect on prices will be. Many potential market players will probably hold off from selling as much as they can, until a more normal financial environment returns. Builders will mothball sites and home owners and landlords will wait and see. Only those that have to are likely to want to sell in current market circumstances. One outcome is likely to be significant: local variations in the scale of impact of the credit crunch. London may be particularly badly affected because of the importance of financial services to its economy. Regeneration areas that previously have seen large amounts of new building may be particularly adversely affected.

7.28 There is little sign of a revival in mortgage lending. So, the prime concern about the housing market will remain the shortage of available funds to finance borrowing. When the situation will significantly improve is hard to forecast. Many commentators believe that it will be well into 2010 or beyond before full liquidity comes back to the mortgage market. But once the decline in sterling abates, lending funds into the UK may become more attractive for overseas investors and property prices will look particularly attractive in foreign currency terms at that time as well. However, the precise ending of the credit crunch is hard to predict.

7.29 However, whatever the timing of the revival, the mortgage market will look different from what it does today. Many providers have already changed, through retrenchment, takeover or merger. The pure RMBS funded operators may find it difficult to re-emerge as important players while other types of capital market funding may grow in importance.

7.30 Lender spreads are likely to stay wider than they have been in recent years; risk assessments will be more stringent and expensive; and there will probably be greater risk-based pricing of loans and loan conditions, with greater equity required from some borrowers and higher borrowing costs for such products as larger LTV loans. This will obviously impact on price growth in the future and may well affect places differentially. We look at those local risks next.

Local impacts

7.31 The importance of house building in regeneration goes further than the size of the construction sector. In some former industrial centres recent economic prosperity has often been associated with a boom in new house building, particularly new apartments in city centres. This has contributed to local economies both by providing construction industry jobs and by providing physical regeneration. This in turn has made the areas more attractive to broader inwards investment. There is
now not only concern that the housing market crash has punctured the bubble but also that the market for two-bedroom apartments, which form the bulk of city centre construction, has a bigger demand-supply imbalance than the housing market as a whole. Data suggests that the house building downturn has been particularly acute in the larger Northern and Western cities (METS2s) and also possibly in a number of smaller centres.

7.32 The only relatively up-to-date information is at the Government Office Region level. There is a clear Northern-South divide in Figure 7.4. It shows the forecast change in housing completions for the English regions in 2008 relative to 2007. Figure 7.5 shows the estimated fall in investment in new housing relative to GVA* by region for the whole of the UK. It shows a rather more complicated picture which highlights the extent of the problem in a number of regions.

Figure 7.4: Housing Completions in 2008

% change

[Bar chart showing the percentage change in housing completions for different regions of England in 2008 relative to 2007. The regions are ranked from highest to lowest in terms of percentage decrease, with negative values indicating a decrease.]

Source: Oxford Economics

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4 This is not quite the same as the impact on GVA growth in 2008 as some materials used in new housing construction are likely to be produced outside of the region.
Figure 7.5: The Projected Fall in New Housing Investment Relative to GVA

Source: Oxford Economics

Conclusion

7.33 There are risks in forecasting developments when the financial and economic circumstances are so uncertain. However, this chapter has attempted to provide judgements of potential developments. There is agreement on the likely scale of the downturn, the places it will affect most and the length of time it will take to recover. All places will be exposed but those with substantial employment in construction and financial services may be vulnerable. Whatever happens, regeneration will continue to face major challenges. We turn next to who might do what about responding to the challenges and mitigating the risks.
Chapter 8

What are the policy implications?

8.1 This report is intended to be a short, sharp account of the impact of the credit crunch upon regeneration in England. It has not been easy to write. It is a moving target and there remains much uncertainty about the future. Also on the face of it the problem is simple. Lenders won’t lend; sellers won’t sell; builders won’t build; buyers won’t buy. But the underlying issues are complicated. Also, there are real concerns that if regeneration activity is halted now a generation of skills and capacity which has been slowly built up during recent years might be lost.

8.2 However three things are clear. First, the financial crisis, in particular, is as severe as anyone can remember. Second, it is not over yet and the pressures on regeneration will get more intense in the coming months. Third, this means that identifying and sticking to some clear principles to guide our behaviour in the future will be even more important. Those principles are not rocket science. Mainly they are those which partners have developed together in the recent good times. Indeed a crucial message from this report is that principles which are good in good times are even better in bad times.

8.3 This report has tried neither to exaggerate nor to underestimate the scale of the challenges involved. Confidence is crucial in the development and regeneration industry. All partners have emphasised the risk of the self-fulfilling prophecy as potential investors, developers, builders and buyers reinforce their fears of decline — and hence make a bad position worse. Before we ask what is to be done, we quickly reprise what we have found out.

What have we learned?

8.4 Some general messages have emerged from the study, which have been embraced by many partners in the industry. The impact of the credit crunch is mixed. It is better in some places and some sectors than in others. But this is not the first time we have seen such crises. We have been here before – twice in recent memory in the 1970s and 1990s. It is not the end of the world. Life will go on. But the system will not recover quickly.

What has been most affected and why?

8.5 The essential features of the crisis have been well rehearsed in this study. There is a consensus upon what has happened, what might happen and what should happen next. There is agreement that there has been a flight from risk and a flight to quality. This means that economically and financially marginal places, projects, partners and people are most affected. In terms of development, London and the South East so far
have been better protected. But the wider position there may change as the economic downturn hits jobs in the financial services. The North and Midlands have been more badly hit so far. The cities with more robust economies and more entrepreneurial leadership will weather the storm better than others. Small and medium towns which are dependent on single declining economic sectors will be badly hit. Rural areas are not immune from the impact either. Paradoxically public sector employment may protect places from the worst of the recession, as it did in the 1990s.

8.6 In terms of sectors, housing has been most badly hit. This especially applies to city centre apartments, buy-to-let and volume house builders. Other sectors have been less badly affected so far – but the position is worsening. Projects that have started will probably finish. Many projects that were about to start may not. The position is worse where the market has overprovided in recent years and where developers are financially exposed. It is better where the developer has long-term aspirations and resources, where the money was organised before the credit crunch began and where there are pre-lets for projects. Public sector projects have been most likely to continue. The public sector is currently keeping the wheels of regeneration turning.

Who’s doing what about it?

8.7 Partners are trying a variety of coping strategies, although it is too soon to tell whether they are working. They are carrying out strategic land acquisitions rather than new build schemes. They are doing everything to gap fund projects that are crucial to the area. They are recalibrating their Masterplans and strategies bringing forward less risky schemes and putting riskier ones to the end of the queue. Generally the local public sector is doing everything to boost public sector spending and activities.

Some silver linings

8.8 There is some agreement that the credit crunch has brought some benefits, even if they do not outweigh the costs. It allows review of some of the housing policies that were being undertaken in cities, especially city centre apartments. It will allow a focus upon long-term place making rather than simply house building. It will allow the public sector to buy land cheaper. It will allow and encourage the public sector to get into longer term relationships with committed long-term developers. It will allow the public sector to provide the necessary physical and community infrastructure that would underpin sustainable regeneration. But these benefits are medium term whereas the costs are immediate.

What are the future risks?

8.9 There are some obvious fears shared by all partners. There is a risk that projects will be mothballed or abandoned. There is a risk that there will be pressure to reduce standards. There is a risk that Section 106 will not deliver in future the levels of
social housing it did in the past. There are risks that if the public sector and the RSLs buys up too much unsold private housing and puts social tenants in them they might be reinventing the socially segregated estates most places have spent a decade trying to eliminate. However, all partners are agreed that the real risk is for the future. There is great concern that the pipeline will dry up so products will not be coming on to the market in two or three years time. There are concerns about the loss of momentum, confidence, investment, skills and capacity. If regeneration is halted now there are fears that it will take a long time to deliver products once the economy does revive. Many experienced people have already been lost. The regeneration industry can ill afford that loss of capacity.

**Investment, risk and innovation**

8.10 There is considerable agreement that the financial model which underpinned regeneration during the past decade has been challenged by recent events. The banks and investors which paid for it in the past are unlikely to do so in the same way in future. Many have argued that long-term financial partnerships between the public and private sectors – and the use of public resources in those partnerships – will become a more fruitful way forward. There has been much discussion of the merits of asset based vehicles in recent years. The details are complex and they vary. But many partners have stressed that such ventures will be the best way in which sufficient resources will be created for regeneration in future. To over-simplify the point greatly, at present the public sector has physical resources if not so many regeneration skills, whereas the private sector has many of the skills but few resources. A number of public sector organisations have been developing these initiatives. There is great support for the general principle that the public sector should become more of an investor in long-term regeneration, sharing the risk and sharing the rewards and recycling them for future projects. There is a wish for the new Homes and Communities Agency to endorse those principles. This study has shown some long-term developments in such arrangements are managing to keep going. So there is evidence that a more general application of these principles will bear fruit in challenging times.

8.11 A variety of partners have identified the new tax on empty properties as a key challenge for regeneration which makes marginal schemes in regeneration areas even more marginal. The pre-budget report proposed some amendments to this application. Many have welcomed that change. But they would also like government to consider further amendments to its impact in regeneration areas.

**Place making and house building**

8.12 This report has shown that housing has been badly affected by the credit crunch and will continue to be so in future. Many partners believe that the housing business model that underpinned the boom of the 1990s will not work in the next business cycle. Even before the crisis there were real concerns about the over
The provision of city centre apartments and the absence of family homes and the infrastructure that makes them viable. Addressing these issues will remain a challenge. Equally, there is clearly a demand for rented market accommodation in many places. But the credit crunch has highlighted the weaknesses of the buy-to-let system which depends heavily upon the individual landlord rental model. Many partners have called for a financial system which encourages major institutional investors to become involved in the long-term provision of private rented housing that would give the flexibility of the current system and better standards. More generally many partners have welcomed the renewed policy focus on place making rather than simply house building – with its greater emphasis upon the provision of social and physical infrastructure. One benefit of the slowdown in regeneration is that it offers a real opportunity for the public sector to make the infrastructure provision now so that places are more ready to benefit from renewed private sector investment when the upturn does happen.

Additional economic drivers?

8.13 The last decade has been a very good decade for English cities. They have undergone a substantial renaissance underpinned by a successful national economy and buoyant public spending as the State of the Cities made clear. But the sectors of the economy which underpinned their renaissance in that cycle may not be the most appropriate for the next cycle. The drivers of much of the renaissance were retail, leisure, residential and financial services. These are primarily consumption or service sector activities. They may not be as robust in the next years. Many partners have stressed that in future places should think of more high value added production activities based upon innovation and learning or more sustainable sectors which feed into the national and global low carbon and sustainability agenda.

What should we do? Some key principles

8.14 This report was not intended to be a list of action points for government. Nor was it intended to unravel the complexities of the global financial system. Rather it was intended to take a snapshot of what is happening in regeneration and identify some clear principles for future action for partners. The key messages that have emerged from this study are simple and obvious. But they are nevertheless true. Virtually all partners have emphasised the need to:

- Pursue long-term principles and goals;
- Provide brave leadership;
- Maintain commitment to the regeneration agenda;
- Deliver quality products in future;
- Provide financial innovation;
- Work even more in partnership;
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- Increase flexibility especially in the planning system;
- Retain capacity;
- Prepare for the upturn; and
- Provide public resources and programmes.

8.15 It is agreed that the property and economic downturn will get worse before it gets better. The pressures upon all partners in the regeneration industry will become more not less intense. But they will be the same pressures to which they are already exposed. Given the pressures are more intense, it is important that the principles of behaviour are clear and understood. It is crucial that all partners do what they can to maintain momentum and optimism. The markets will eventually recover. It is important to prepare for that upturn whenever it comes.

8.16 At difficult times it is important to remember that regeneration is a long run game. Where long-term plans have been made with strong developers, they will ride out the storm. Projects and principles which were good a year ago are good today and tomorrow. Policy has shifted too many times too quickly in the past with many promising urban policy babies thrown out with the bath water. The credit crunch should not be an excuse to repeat that process. All partners, especially the private sector have underlined that. The public sector and the government in particular must continue to show leadership on the regeneration agenda. It must not blink and it must not panic. The government should demonstrate it is committed to long-term regeneration. The private sector in particular is looking for commitment from government so that they too can stick with regeneration.

8.17 This report has focused mainly upon the physical impact of the credit crunch upon regeneration. But it has also highlighted the social and human consequences. Many communities that have experienced difficult times for many years have been badly hit by the downturn. It is crucial that everything is done to protect the plans that were made for those communities. Many regeneration agencies are concerned about breaking moral commitments to communities if they cannot deliver agreed projects.

8.18 More generally this study has underlined that the private sector has become risk averse and may be more reluctant in future to commit to projects. It has also shown that at the moment it is the public sector which is keeping going much of the regeneration activity in this country. It is critical that the public resources that are already committed to regeneration until 2011 should be reviewed to see whether they can be brought forward. Equally it is important that the wider public programmes which are not typically regarded as regeneration should be more closely aligned with regeneration aims and ambitions in future. The resources going into the building of schools, clinics and hospitals should wherever possible complement regeneration programmes. At present it is not clear this always happens.
8.19 Government financial support and commitment for regeneration should not lead to increased central control. Government should provide the framework, leadership, commitment and resources that will best sustain and revive regeneration activity. But it should not be tempted to second guess local partners and get involved in decisions about particular projects. That is a local and regional responsibility and best done at those levels.

8.20 The evidence of the past decade in the good times was that developers, development and investment will go to places where:

- There is a clear long-term plan for the place;
- The private sector is valued;
- There is real commitment to partnership;
- There is committed local leadership; and
- There is local efficiency, innovation and flexibility.

There are many examples of this. Those principles will become even more important in future. Getting out of this crisis is not a challenge for government alone. All partners public and private, local, regional and national will have to play a part.

**Difficult but doable**

8.21 The key message of this report is that partners must not panic in the face of the financial and economic challenges they currently face. The market is very difficult. But it is not dead. Many regeneration schemes are continuing and will continue. Projects which have public sector funding, financially sound developers in places and where the market has not over-provided are continuing. It is crucial they — and others in the pipeline — do happen. Also although the immediate position is difficult, many longer term schemes have not yet been badly affected. That is a cause for optimism. There are also some silver linings. There are opportunities for partners to: take stock, get some better land deals for the public sector, put in some community and physical infrastructure and make the right decisions now so places are ready to benefit from the eventual upturn. History tells us these periods end. The market will come back, confidence will be restored and regeneration will also begin again. But it will be different. And we may need to find some new solutions to new challenges.

**Maintain the Commitment**

8.22 Most important the good principles that have worked in the past will work again in the future. We must support an approach which encourages: long-term thinking and planning; government commitment; public-private partnership and investment which shares risks and rewards; more efficient, flexible and innovative local leadership and decision-making; a commitment to economic and social as well as physical regeneration. It is the best model we have for working together in the bad
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as well as the good times. The next period will present some challenging questions and problems. It is crucial we use the time not panicking but finding some good answers and solutions. Regeneration is a long haul business. There is every reason and need to continue with it. The motto for all partners, especially government, must be ‘maintain the commitment’.
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