Impact of the credit crunch on physical regeneration in Lambeth

All Wards

Report authorised by: Executive Director of Housing, Regeneration and Environment: Chris Lee

Executive summary

The purpose of this report is to set out the impact of the credit crunch on physical regeneration and how this may affect existing and future regeneration schemes in the borough.

This report is only one part of the council’s response to the credit crunch:
- Lambeth Council in November 2008 was presented with the findings from its Credit Crunch Task Force.
- The Finance Scrutiny Sub-committee also considered the implications of the credit crunch on the Council’s financial position at its meeting in December.

The Regeneration and Enterprise Division is also looking at its activities to proactively manage the consequences of the economic downturn, while also planning for the future to take advantage of opportunities that will benefit local communities and businesses.

These opportunities are the focus of this report. The report concludes that councils that are open for business, open to the prospect of development, and proactively seeking new funding models will be better placed to weather the economic downturn.

Boroughs such as Lambeth, that are also working in partnership, supporting businesses through revised town centre management arrangements, and have undertaken preparatory work such as the development of masterplans to create the conditions for inward investment, also stand best to weather the impacts of the current downturn and get the most out of the future upturn.

Summary of financial implications

There are no financial implications arising directly from this report.

Recommendations

(1) That the Overview and Scrutiny Committee notes the information contained within this report.
Consultation

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Report history

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Report author and contact for queries:
Paul Ewing, Senior Project Officer Divisional Support, Regeneration and Enterprise
020 7926 2585 pewing@lambeth.gov.uk

Background documents

- **Regeneration Delivery Plan – Future Lambeth** (Cabinet, November 2006)
- **Future Clapham Award of Contract** (Cabinet, December 2007)
- **Future Clapham: Award of Contract - Call-ins of Cabinet decision** (Overview and Scrutiny, January 2008)

Appendices

None
Impact of the credit crunch on regeneration

1. Context

1.1 In 2007 and more acutely in 2008 there was a significant shift in the global economic climate, the repercussions of which are likely to continue through 2009 and beyond.

1.2 Over the last ten years (1997-2007) the UK economy has seen steady growth, with the average house price in Lambeth rising from £109,053 in 1997 to £382,614 in 2007 (Halifax Index), which is an increase of 351%.

1.3 However later in 2007 and 2008 saw a significant shift in the economic environment. Residential values in the UK have declined by 15% over the last year (Dec 2007- Dec 2008). The FTSE 100 fell by 31.3% over the same period (Bloomberg). Commercial rental values have declined by more than 20% in 2008 with forecasts they will continue to fall by average of 18% in 2009 and 2010. Beyond 2009, the pipeline of new developments is anticipated to be limited due to funding issues (IPD).

1.4 The causes for change in the economic picture over the last two years are truly global in origin as reflected by the fact that the cuts in UK interest rates having very little impact on rates presented by banks for lending purposes.

1.5 A recession is now upon us, its full impact and duration are still unknown. Toward the end of 2008, emerging signs were that this downturn could be more severe than previous ones with the following indicators:

1.6 London’s economic growth (GVA) forecast to slow to 0.8 per cent in 2008, falling to 0.2 per cent in 2009 before rising to 1.9 per cent by 2010.

1.7 July to September 2008: 58,000 more unemployed London residents compared to a year ago. Increase in London’s unemployment rate by 1.3 percent.

1.8 A recent LGA report predicted that London is one of the most vulnerable regions to negative effects of economic downturn and job losses nationally.

1.9 Construction expenditure across all sectors forecast in 2009 to fall 8.5%.

Other council activity to respond to the credit crunch

1.10 This report is only one part of the council’s response to the credit crunch:

- Lambeth Council in November 2008 was presented with the findings from its Credit Crunch Task Force. This task force was set up in a bid to help residents through the current global financial crisis. The findings included 27 recommendations to address issues related to income, credit and debt, energy and fuel, housing, and worklessness. The council’s response to this report will be considered at 9 February 2009 Cabinet.
- The Finance Scrutiny Sub-committee also considered the implications of the credit crunch on the Council’s financial position at its meeting in December.
1.11 The Regeneration and Enterprise Division is also looking at its activities to proactively manage the consequences of the economic downturn, while also planning for the future to take advantage of opportunities that will benefit local communities and businesses. This includes:

- Tackling employment and addressing worklessness (Employment, Learning and Skills)
- Practical support for businesses (Business, Growth and Enterprise)
- Leading on a Lambeth First neighbourhood working pilot in Brixton with a town centre director, working closely with the Metropolitan Police Service, to support its marketing and commercial development (Brixton Town Centre Director)
- Preparing for the economic upturn by developing masterplans and regeneration schemes (Physical Regeneration)
- Prioritising delivery of current major schemes (Physical Regeneration)
- Implementing “quick win” projects to support commercial town centres (Physical Regeneration).

2. Proposals and reasons

2.1 Background to the credit crunch

2.1.1 The last 10 years have seen significant growth in China with the increase in wealth expanding at a dramatic rate. Much of this newfound wealth has been invested in the US economy, so much so that it helped enable US banking institutions to invest significant sums of money in what are known as NINJA mortgages (No Income, no Job or Assets). These mortgages were lent at high risk. This high risk lending has become known as Sub-prime.

2.1.2 Sub-prime assets owned by banks were broken down and sold as part of investment portfolios to other banks. This was to dilute the risk but in reality, the break down of sub-prime assets meant that many investors had no idea where their money was invested, or their exposure to these high-risk assets.

2.1.3 As US house prices started to fall it became clear that repossessions would not generate enough revenue back to investors to cover their original outlay. It became apparent that investments were not returning profits and that billions of dollars, pounds, or yen had been lost.

2.1.4 These massive losses and the increasing reluctant nature of banks to lend money to each other to protect themselves from poor investment sparked a chain of events over late 2007-2008, which saw the fastest swing from a prosperous global economy to almost global recession since the Great Wall Street crash of 1929.

2.1.5 Banks have frozen lending to each other, firms and individuals to protect and reduce any further haemorrhaging of cash. Governments have stepped in to try to bridge the loss of funds and return some order to the global economy. However it has become clear how much companies, particularly those in the UK, have become reliant on debt funding to manage their businesses.
2.1.6 Prior to this, historically low rates of interest and a general availability of funds had caused property prices to rise to a point where it was almost impossible for a 1st time buyer to purchase a residential property within comfortable means.

2.1.7 Historic capitalist boom and bust characteristics have not been solved and there is real concern that the boom has been for such an extended period the downturn is now likely to have devastating consequences for business and individuals over the next few years.

2.2 Key features of the credit crunch

There are several key impacts the credit crunch has had on the property development sector:

i. Banks are lending less to developers; they have increased their charges and are seeking greater profit margins

ii. Banks are lending less to individuals to purchase new residential properties from developers (mortgage finance)

iii. Consumers are spending less money on goods and services in anticipation of monetary problems and the need to meet the demands on essential items such as mortgages, food, heating etc

iv. Companies are laying off staff due to the reduction in demand for their products that means individuals have a reduced or no source of funding to pay mortgages

v. With increases in repossessions and less mortgage approvals taking place, demand for residential developments – and more specifically the ability to buy new residential properties – has fallen

vi. With the inability to raise finance and the decrease in demand for housing, speculative development has all but stopped in the UK. This is having knock-on effects for associated trades and companies, such as with the retailer MFI

vii. Demand is dropping, and so are prices. This has an impact on the bottom line of developers as old stock is now not worth the anticipated sales price. Developers also cannot raise revenue to secure profits on existing or pending schemes

viii. The commercial property sector is also experiencing liquidity problems. Occupiers are cutting back as demand for their goods and services are decreasing

ix. Rents are starting to fall due to a decrease in demand

x. There are more vacant units on the high street due to the demise of retailers such as Woolworths, MFI and Adams.

2.3 Impact on large regeneration schemes

2.3.1 Large development projects appear more exposed to the impacts highlighted in the section above, due to the amount of investment needed, the amount of properties that need to be sold, the timescales (sometimes involving several phases), and the increased risks.

2.3.2 For example, Woodberry Downs in Hackney is anticipated to provide 4,000 homes over the next 20 years, however the first phase of the scheme which is to provide approximately 1,000 homes has yet to get underway and is currently 2 years behind schedule.
2.3.3 With regard to the Brixton and other town centre masterplans, as these are regeneration strategies which have a long term focus (compared to small schemes which have a 2-3 year life cycle from planning to completion), fluctuations in market conditions will have a smaller impact. Nevertheless, as part of the process to finalise the masterplans, the impact of the economic downturn on the long term vision is being taken into consideration. Similarly, the masterplans recommend projects in the short and medium term that will respond to the credit crunch as quick wins to support commercial town centres, and help mitigate some of the impacts of the recession.

2.4 Impact on smaller schemes

2.4.1 The main impact of the credit crunch on smaller schemes is that it has led to delays or re-phasing of regeneration schemes and re-negotiation about delivery. Only a few boroughs have seen schemes stopped/developer withdrawal and the key reason for the delays is access to finance.

2.4.2 Throughout London there are increasing cases of developers who have agreed to buy land, own property and even have planning permissions, consulting with landowners and councils with a view to re-negotiating deals and change planning applications.

2.4.3 Future Clapham has seen such an issue over the last six months as the impact of the credit crunch has continued. There is provision within planning policy to allow for a reduction in affordable housing if it can be demonstrated that this is necessary to deliver a viable scheme. The scheme has changed, within the provisions of planning policy, to attempt to deliver a workable scheme with an increase in the height and massing on the scheme and a reduction in affordable housing, while protecting the investment in public facilities.

2.4.4 The Future Clapham Developer has stated:

*The credit crunch has had a profound impact upon the financial and property industries.*

*Credit lines remain paralysed and the banks appear to simply not have the ability to be able to lend money. Their entire focus has been to recover existing loans, rather than properly consider new business. In our opinion, the government’s rescue package will probably end up being insufficient and the re-capitalisation of the banks will have to be repeated as the banks continue to suffer significant write downs on the value of their assets.*

*Like all businesses, we are not immune from the effects of the crisis, although we are probably far less exposed when compared to many. We have found it extremely difficult to raise any new finance and have had to reduce our internal costs. Cash preservation is therefore critical as it is extremely difficult to generate or raise cash in the current circumstances.*

*Our project portfolio is very diverse and we are working hard to identify innovative new business models and work with key stakeholders to progress schemes in the current climate. All sectors of the property*
industry are affected, and the only models which are currently feasible involve a significantly de-risked position.

Our business model and company structure allows us to be far more flexible than many of our larger competitors and we are therefore able more quickly to adapt to change and therefore envisage that the recession will also generate opportunity.

We are already seeing signs that construction inflation has slowed dramatically and prices are starting to come down. We now see this process continuing and some of the falls in value will be partly offset with reduced costs. There is real potential for deflation within the sector.

Whilst cash is currently in short supply, interest rates are, and are likely to remain low and it is likely that equity investors will come into the market, once things start to improve. This is very different to the last recession, when borrowing costs were prohibitively high.

2.5 Opportunities during the credit crunch

2.5.1 Using an economic downturn to plan for future schemes and to take advantage of future improved market conditions is often advised and Lambeth Council has been doing this with the preparation of masterplans for its town centres (Brixton, Streatham and Norwood), and the development of Supplementary Planning Guidance for Waterloo and Vauxhall.

2.5.2 Furthermore, as property prices fall there can be the opportunity for land banking and site assembly to take place for delivery of schemes in the future.

2.5.3 The advice the council continues to receive from the experts is that in recessionary times where access to debt finance is restricted, cash really is king. Companies that can invest their (past) profits in discounted properties and distressed developments will have the edge on their competitors when better market conditions return.

2.5.4 Many developers are holding off developing projects until the market improves, however they are still spending time ensuring they obtain good planning permissions that they will be able to access as soon as the market returns. If they wait until the market improves to submit applications, they may have an extended period of poor returns to contend with.

2.5.5 There may be an opportunity for Lambeth to agree development strategies/joint ventures/options with developers to deliver some of the longer-term projects. There is also the opportunity for the Authority to gain planning permission on its own properties to maximise its assets.

2.5.6 The food retail sector has been historically recession resistant. This has been especially true of supermarket chains such as ASDA, Tesco and Sainsbury’s. In fact Sainsbury’s have demonstrated increased profits within 2008. With the recent receivership of Woolworths and M&S’s commitment to close several of its Simply Food outlets there may be further expansion in this sector.
2.5.7 Another area currently appearing unaffected by the economic downturn is Student Accommodation. Accommodation can provide long-term low risk investments protected by Universities and educational institutes. Over the last year several development sites in London which appeared to be prime private residential development opportunities were out-bid by student accommodation providers.

2.5.8 Other schemes which maintaining a healthy demand include such uses as Care Homes and Key Worked/Affordable Housing, especially where the recently formed Homes and Communities Agency (HCA) has the ability to may purchase land and deliver projects in the current market.

2.5.9 The emerging role of the HCA to invest in boroughs is another potential opportunity during the credit crunch. The Homes and Communities Agency joins up the delivery of housing and regeneration under one roof, bringing together the functions of English Partnerships, the investment functions of the Housing Corporation, the Academy for Sustainable Communities, and key housing and regeneration programmes previously delivered by Communities and Local Government, including the Thames Gateway, Housing Market Renewal, Decent Homes. The intention with this integrated approach will enable the HCA to hold a 'single conversation' with local authorities and other partners on the specific housing and regeneration needs of their individual areas.

2.5.10 Councils that are well placed to deal with the credit crunch will be councils that are open for business, open to the prospect of development, and proactively seeking new funding models will be better placed to weather the economic downturn. Boroughs such as Lambeth, that are also working in partnership, supporting businesses through revised town centre management arrangements, and have undertaken preparatory work such as the development of masterplans to create the conditions for inward investment, also stand best to weather the impacts of the current downturn and get the most out of the future upturn.

3. Comments from Executive Director of Finance and Resources

3.1 Across the three year period from 2007/08 to 2009/10, the Council has allocated £10.840M of capital funding to support the delivery of the Physical Regeneration programme. This investment to date has enabled the planned inward investment and development of multi-million pound schemes including Future Clapham and “Streatham Hub”.

4. Comments from Director of Legal and Democratic Services

4.1 The Council has a duty to maintain a balanced budget throughout the year and should plan for unusual events and circumstances.

4.2 Section 2 of the Local Government Act 2000 provides that the Council has the power to do anything, which it considers likely to achieve one or more of the following objects

- The promotion or improvement of the economic wellbeing of the Council's area
• The promotion or improvement of the social wellbeing of the Council's area
• The promotion or improvement of the environmental wellbeing of the Council's area

4.3 Under this power the Council can:

• Incur Expenditure
• Give Financial assistance to any Person
• Enter into any arrangement or agreement with any person
• Co-operate with or facilitate or co-ordinate the activities of any person
• Exercise on behalf of any person any functions of that person, and
• Provide staff goods, services or accommodation to any person.

5. Results of consultation

5.1 Not applicable.

6. Organisational implications

6.1 Risk management:
The impact of the credit crunch has been identified as a risk where appropriate within existing programmes as part of the council’s risk management framework.

6.2 Equalities impact assessment:
Individual regeneration schemes have undertaken an equalities impact assessment. The impact of the credit crunch however has the potential to delay the benefits anticipated within these programmes.

6.3 Community safety implications:
There are no implications.

6.4 Environmental implications:
There are no implications.

6.5 Staffing and accommodation implications:
There are no implications.

6.6 Any other implications:
The credit crunch will continue to have an impact upon the finances of local authorities and the Audit Commission has reported that many local authorities are well positioned to ride out the immediate effects of the credit crunch.

The Improvement and Development Agency (IDeA) in collaboration with the Local Government Association has also produced a series of case studies from local authorities to highlight how local authorities to date are addressing the impact of the immediate downturn as well.