Infrastructure Finance Review

5 June 2019
To: InfrastructureFinanceReview@hmtreasury.gov.uk

Introduction and background

1. The British Property Federation (BPF) represents the real estate sector – an industry with a market value of £900bn which contributed more than £60bn to the economy in 2016[i]. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.

2. We welcome the opportunity to respond to this consultation on infrastructure finance and share the government's acknowledgement of the of the importance of technology. It is crucial that the real estate and infrastructure industries can adopt and respond to emerging technologies, to ensure that the built environment we create today is fit for the 21st century and beyond.

3. We are also pleased to see a strong commitment in the consultation to support the development of housing. Our members have been at the forefront of a new residential asset class designed specifically for rental, known as Build-to-Rent. This asset class is a popular investment for institutions, like pension funds and insurance companies, who are attracted by the long-term income streams from such a product; but are typically averse to riskier activities, like construction and development. Other funders are also wary of providing finance to such a new asset class because there is a lack of track record of the asset's performance. We believe the government would be well placed to 'de-risk' the construction phase of Build-to-Rent developments, which could unleash significant investment from institutions to contribute towards the housing crisis.

4. Our submission has focussed on chapter 3 – responses to the consultation questions are within the appendix. We provide our views on existing investment models and tools, as well as give some insight on technological advances in the sector. We would be pleased to discuss our comments with you in more detail - please do not hesitate to get in touch if you require further information.

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Appendix 1: Chapter 3 - Investment models and existing tools

Question 10: What is your view on the effectiveness of the existing government tools to support the supply of infrastructure finance?
Question 11. Should the government change, expand or reduce the levers it uses to support the supply of infrastructure finance?

5. ***Housing Guarantees – Built to Rent***

6. Harnessing long-term institutional investment into Build-to-Rent (BTR) homes could play a significant role in addressing this country's housing crisis. To that end, we are supportive of the existing guarantees as set out in the consultation document and would encourage government to continue this support.

7. In particular, we believe the current Private Rented Sector Guarantee scheme should continue. Although there was a concern originally that this initiative was not well timed; the BTR sector is now just starting to deliver stabilised assets in a more significant quantity, which was what the guarantee was there to support.

8. There is an additional product that Government should consider, which would support the provision of more private sector development finance of BTR. We believe that a government guarantee over a small proportion of a development loan offered by the private sector would help change the risk-profile of loans to Build-to-Rent developers. By changing the risk profile of the entire loan, it would change the "slotting" category, which the finance was categorised as. Slotting regulations restrict the amount of high-risk loans that banks can offer – therefore, our expectation is that by de-risking the original financing through a government guarantee, the capacity of the private sector to fund the development of BTR would be expanded.

9. ***Tax Increment Financing (TIF)***

10. TIF is another useful tool to help unlock funding for infrastructure. This tool has helped unlock significant funding for infrastructure including the northern line extension in Battersea and the Paradise Circus development in Birmingham. We believe there is scope to make greater use of TIF to help unlock more infrastructure across the country, large and small. However, we are concerned that progress has been slow and erratic in developing TIF. A big part of the problem lies in the way the mechanism TIF relies on (retained incremental business rates) has come to characterise it more than its fundamental purpose (unlocking investment in project-specific infrastructure to deliver the jobs, growth, productivity and social and economic renewal that entails).

11. The essence of TIF lies in identifying and ring-fencing an anticipated future income stream so that it can be used to finance substantial upfront investment. TIF is best suited for supporting infrastructure investment which is of a sufficiently large scale (at least in the context of the relevant project) to involve financing periods of up to 25 to 30 years. Failing to ring-fence the income stream for that length of time would generally render the upfront investment unbankable, because the risks associated with it become too difficult to model, understand and price. TIF will only really work with total ring-fencing, rather than simply prudential borrowing.

12. One alternative model (based on the "pay as you go" approach in the US) is commonly referred to as Local Tax Reinvestment Programmes (LTRiP). In simple terms, this might involve the developer of a commercial or mixed-use scheme agreeing to deliver the requisite infrastructure in return for payment out of the business rate increment expected to arise from the commercial development. The developer could use

existing equity resources or loan facilities to fund the infrastructure work. The risk taken by the developer on delivering the infrastructure is essentially similar to the risk he is taking on the delivery of the commercial development (as business rates will be paid if rent is paid). If the developer is willing to rely on that tax increment, the local authority can achieve perfect risk transfer to the private sector: its only commitment would be to pay over a pre-agreed proportion of such increment as it actually materialises (and if the scheme failed completely, the authority would have nothing to pay). Of course, the fact that the private sector is taking the full risk on the business rates increment on such schemes should operate as a further discipline on the use of TIF: while we would expect most local authorities to be responsible in the way they approach TIF, we are confident that developers would only proceed with schemes very likely to succeed.

13. ***Funding for Healthcare infrastructure***

14. Healthcare infrastructure is a crucial aspect of ensuring the sustainable growth and operation of our communities, and we would therefore emphasise the benefit of identifying effective and efficient mechanisms for delivering publicly run healthcare infrastructure in line with the NHS Long Term Plan. It is well documented that a significant backlog maintenance bill exists in relation to elements of the NHS Estate. Through Sir Robert Naylor's Review of NHS Property and Estates, it was identified that approximately a third of the necessary costs for delivering a fit for purpose estate could be borne by private finance. With the abolition of Private Finance Initiatives (PFI), it will now be necessary for the public and private sectors to work more closely with one another. This will be necessary to facilitate bespoke finance structures and development models to help deliver purpose-built healthcare infrastructure according to the needs of particular NHS trusts and local communities.

Question 12: Should the government consider any alternative forms of infrastructure finance support for sectors such as higher education or housing associations?

15. No comment.

Question 13: Which sectors or types of infrastructure may need support from government to raise the finance they need, particularly in light of major technological changes?

16. ***Modern methods of construction***

17. Build-to-Rent is increasingly making using of modular construction – which involves 'modules' being constructed offsite (usually including even plumbing and electrics), leaving only the assembly of the modules to be carried out on site. The main benefits of modular construction are:

i. The construction process is much quicker than traditional construction – allowing the properties to be rented out much sooner.
ii. The quality of construction is high and consistent – reducing snagging expenses and maintenance costs over the long run.
iii. It can be particularly useful when developing in an already built-up urban area, where on-site space is limited.

18. Modern methods of construction are in their infancy on the UK; as such, there are few factories able to provide such a product. Furthermore, given the limited track record of this construction method, lenders typically consider it to be riskier, thus limiting the amount of finance available to Build-to-Rent

developments which deploy modern methods of construction. We believe there is scope for government guarantees or assistance in the short-term to support this industry to grow.

19. ***Emerging trends and technology***

20. Real estate and infrastructure should be at the forefront of emerging trends, to make sure that our built environment is fit for the future and adaptable to accommodate the latest technological advances. As such, the government should continue to support businesses which are researching and innovating in this space.

21. A selection of topical technological developments are listed below where some government support or coordination may be helpful to expediate innovation and ensure a smooth adoption of new technologies:

- *Geospatial data* - to help map what's under the ground and plan infrastructure accordingly.
- *Infrastructure pipeline mapping* – to help developers have visibility of upcoming infrastructure development. The GLA have done some useful work in this area – government may be able to support other LAs or metro mayors in this space.
- *5G rollout* – this will involve the cooperation and coordination of private and public infrastructure and real estate owners and operators. In particular, the wifi spectrum can't travel very far, so it will require the use of space on top of real estate in urban areas (e.g. masts on roofs).

22. We would also like to draw your attention to two reports which we have published recently which go some way to exploring the opportunities for technological advancement in real estate.

Lost in translation: How real estate can make the most of the Proptech revolution
This report considers how change is being driven by digital technology, and highlights trends towards:

i. More flexible use of buildings.
ii. A more service-based approach to property.
iii. The use of sensors to provide more information on how a building is used.
iv. Virtual replicas of buildings to improve design and operation.
v. More adaptable buildings that can cater for uncertain future uses.

The appendix to this report includes a summary of a number of existing technology solutions to drive efficiencies across the lifecycle of a property, from investing and financing, through design and construction to property management and eventually fit out.

The LIQUID report: Leading the digital transformation of global Real Estate
A number of recommendations come out of the liquid report for both government and industry to consider, to help embrace technological innovation in the sector. The recommendations included:

i. Government to publish a roadmap of Real Estate-relevant digitalisation plans.
ii. Joined up government - a Minister-led digital Real Estate forum to be created, and government to create a digital government interface or hub for people to discover and access Government activity relating to the digitalisation of Real Estate.
iii. Use of financial and regulatory levers, such as R&D tax credits – and ensuring that technology that can benefit a building over its entire lifespan is considered within the planning process.

[i] Property Data Report 2017, Property Industry Alliance