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# Barriers to Property Investment and Development in Medium-Sized Cities

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ESRC Seminar Series

Regenerating Medium-sized Cities

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2009



The  
University  
Of  
Sheffield.

# Property and Urban Competitiveness

## Urban Performance ↔ Property Performance

“ The wider economy  
(exogenous influences)



“ The urban economy  
(sectoral/firm make-up)



“ Other urban attributes  
(society, polity,  
location, environment,  
property)

“ The wider property  
market (exogenous)

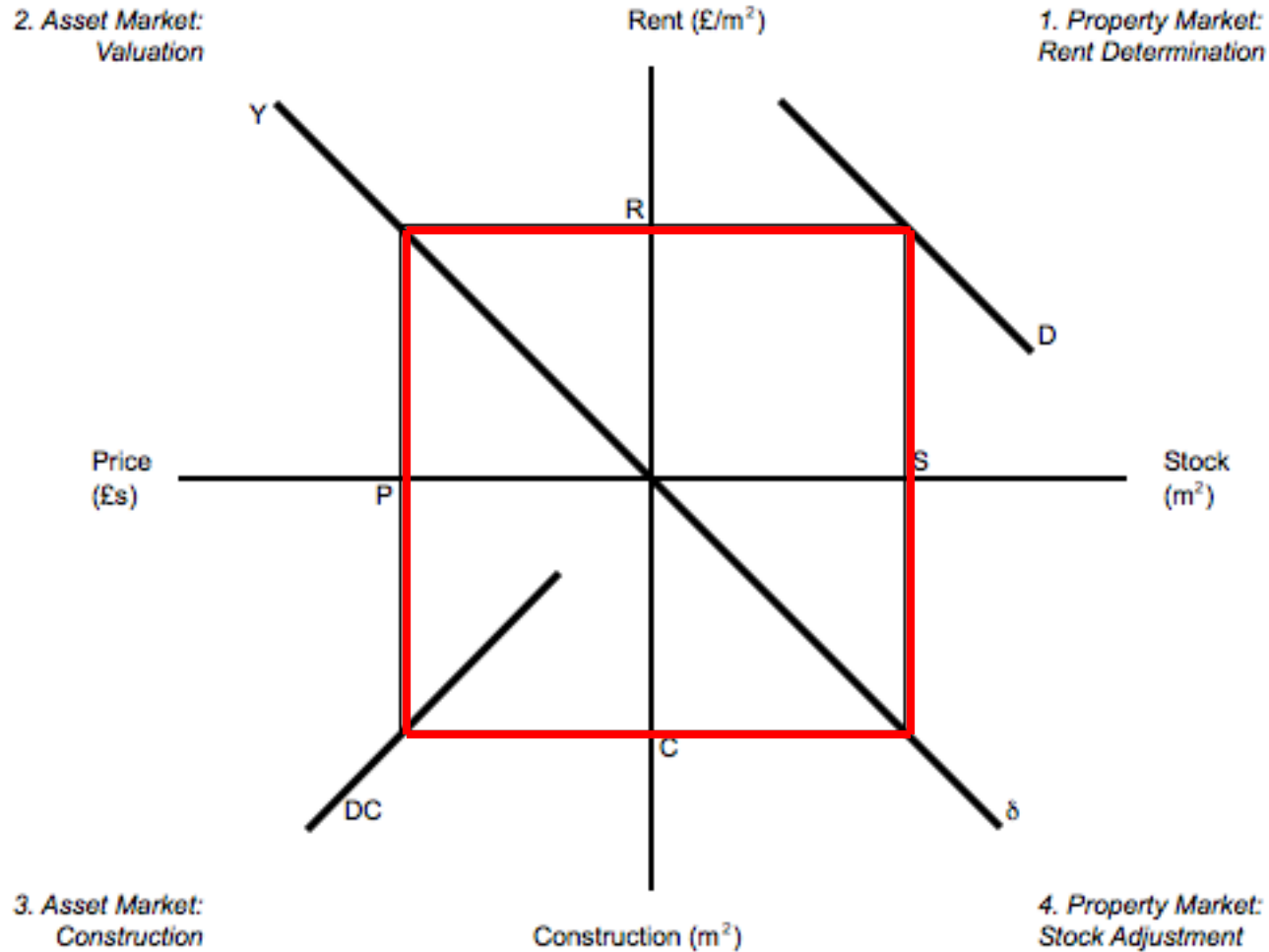


“ The urban property  
market (character)

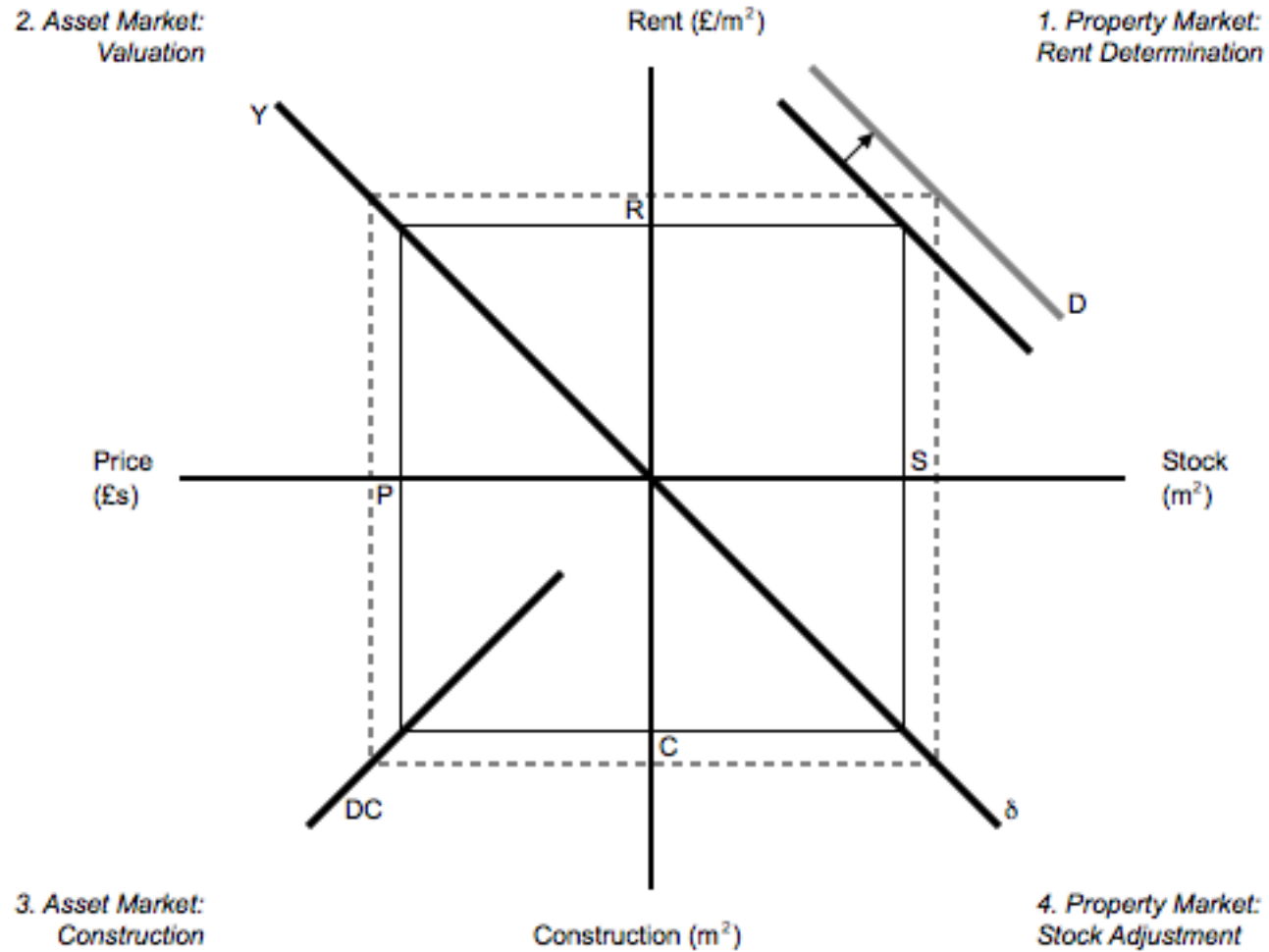


“ The urban development  
and investment sector  
(actors and assets)

Model of the Property Market

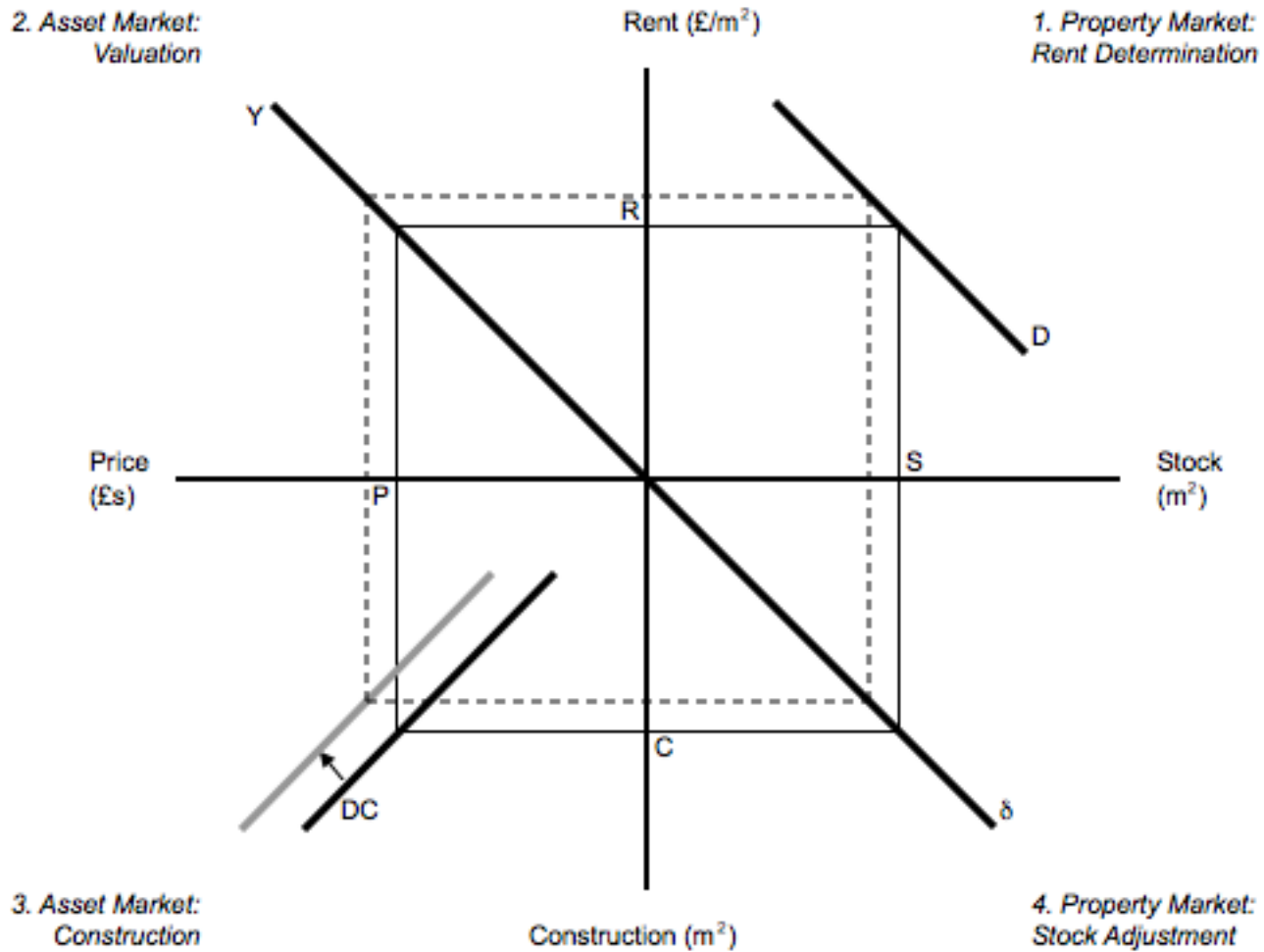


Source: DiPasquale and Wheaton (1996), Figure 1.1, page 8, amended by authors.



Source: DiPasquale and Wheaton (1996), Figure 1.2, page 12, amended by authors.

Investment Costs



Source: DiPasquale and Wheaton (1996), Figure 1.7, page 17, amended by the authors.

# Influences on Urban Property

## Markets: *Investment Yields and Property Prices*

- “  $CV = R/Y$  (Capital Value = Rent/Yield)
- “ Rent determined endogenously; yield determined exogenously (normally)
- “  $Y = r + \rho - g + d$
- “ Yield = f(risk free rate; + property risk premium; - expected growth rate; + depreciation)
- “  $\rho$  and  $g$  have a national and a local component

# How well do yields reflect local performance?

**Table 1: Office Property Investment Returns and Risks, 1980-2003**

<b>Office Market Segment</b>	<b>Total Returns (average pa)</b>	<b>Volatility (SD of returns)</b>	<b>Market Sensitivity (Beta)<sup>1</sup></b>	<b>Liquidity (transaction rate, 2000-2002)</b>
Standard Offices	8.9%	10.6	1.20	20.0%
Central London	9.1%	12.8	1.38	19.0%
Rest of London	7.8%	10.5	1.07	19.8%
Southern England <sup>2</sup>	8.1%	8.5	0.91	19.9%
Rest of UK	10.1%	8.2	0.70	24.9%

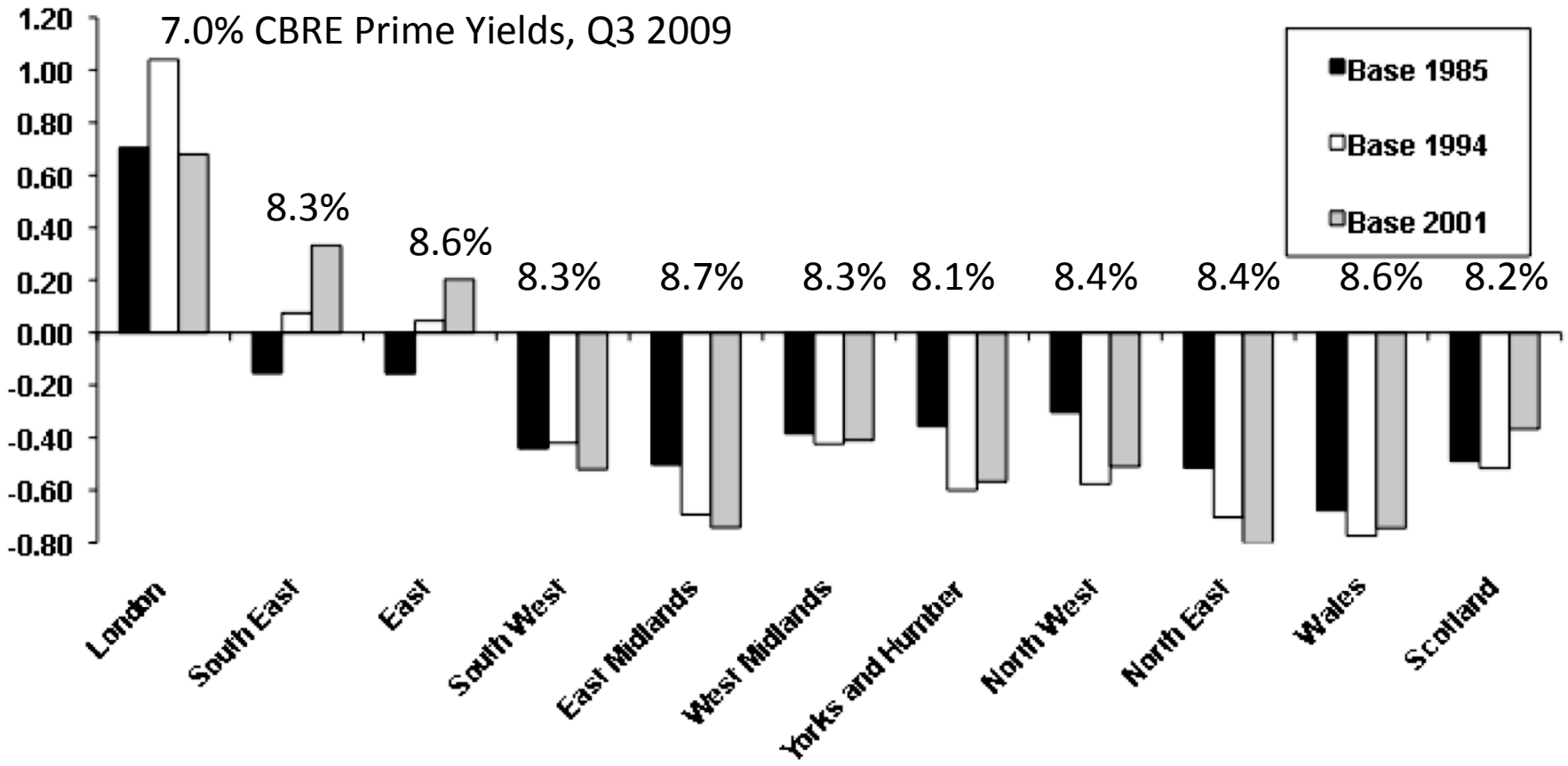
Sources: IPD, 2005; Key, 2004

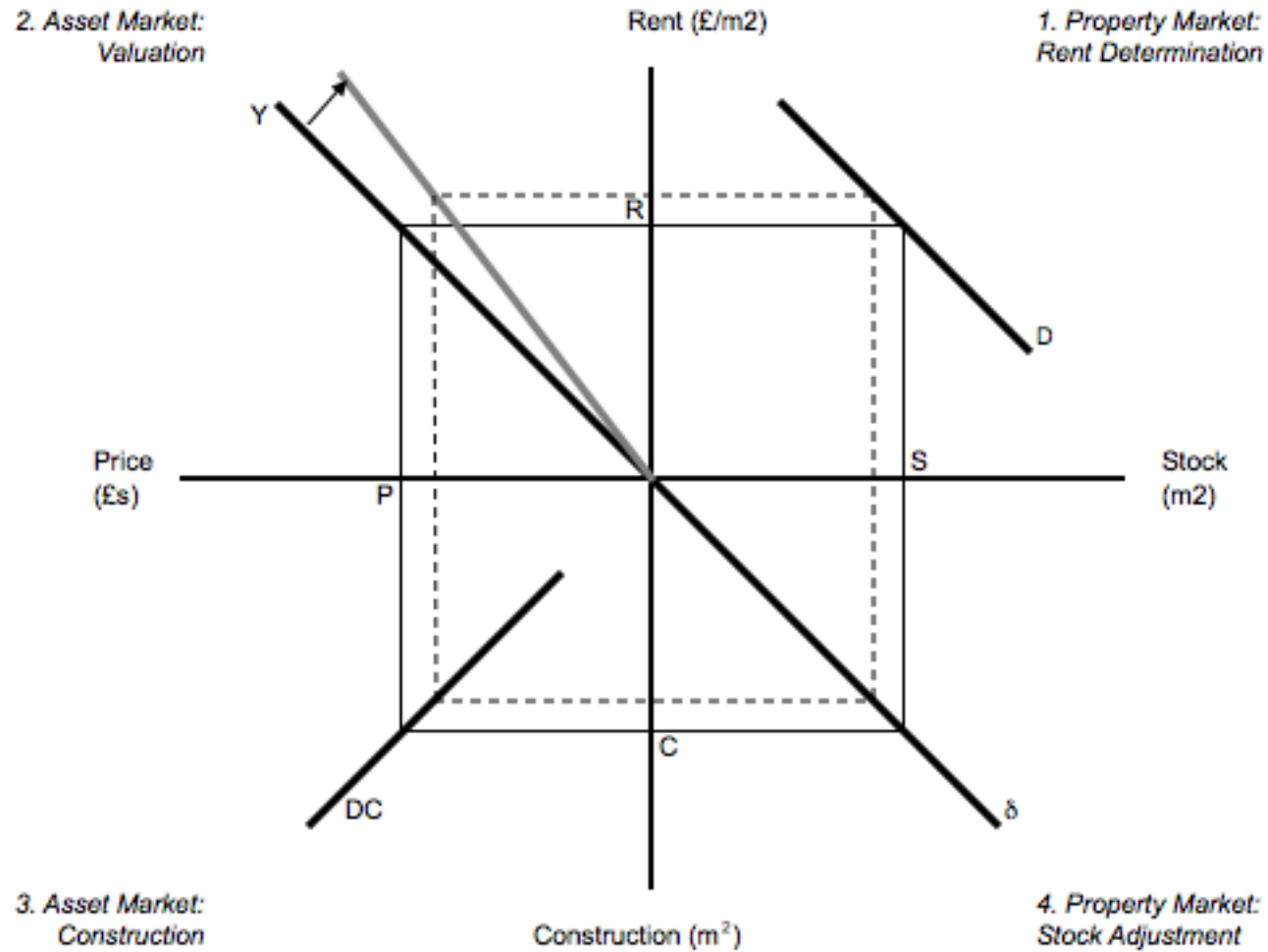
1. Relative to the property investment market as a whole.

2. South East, East and South West.

# Investment Holdings and Yields

Distribution of Office Investment Relative to Regional Business Service Employment





Source: DiPasquale and Wheaton (1996), Figure 1.4, page 14, amended by authors.

# Influences on Urban Property Markets: *Portfolio Management and Benchmarking*

- “ Benchmark is a measure of relative performance (supposedly boosts competition)
- “ IPD benchmark is the *primary* influence on the geographical diversification decision
- “ *“We are constrained by the benchmark; it is more than our job is worth not to.”*  
(Researcher, UK investment management company)

# How does benchmarking work?

- “ Fund performance is measured in comparison to the selected benchmark. The difference between the fund and the benchmark is known as the ‘tracking error’.
- “... a convergence in the portfolio composition of ... funds ... is logical as fund managers try persistently to match the benchmark’s asset structure, attempting to reduce tracking error risk.” (Byrne and Lee, 2003, page 201)

# The effects of benchmarking

*“... if all the management want is for you to beat the benchmark, it is quite easy to do it. By doing this they are not setting us a particularly high target because the benchmark is generally quite low relative to the returns that can be made in property.”*  
(Director of research, Global investment management company)

# The effects of benchmarking

” *“The success of the IPD has definitely limited the scope of fund managers to make independent investment decisions; it always comes back to the IPD. IPD world is self constraining, it has created a view in industry that the further you stray from the benchmark, the further you will fall, i.e. if you go against the benchmark, the market will sting you. If you ignore the benchmark, you are leaving yourself open to being caught out.”* (Fund manager, Fund management company)

# The effects of benchmarking

” *“The fund wants investment in London, greater London at a push – this means that we have the biggest and best buildings of any fund in the company. I certainly wouldn’t want to be having to invest in piddling little markets miles away from the core.”* (Director of property funds, UK investment management company)

# The effects of benchmarking

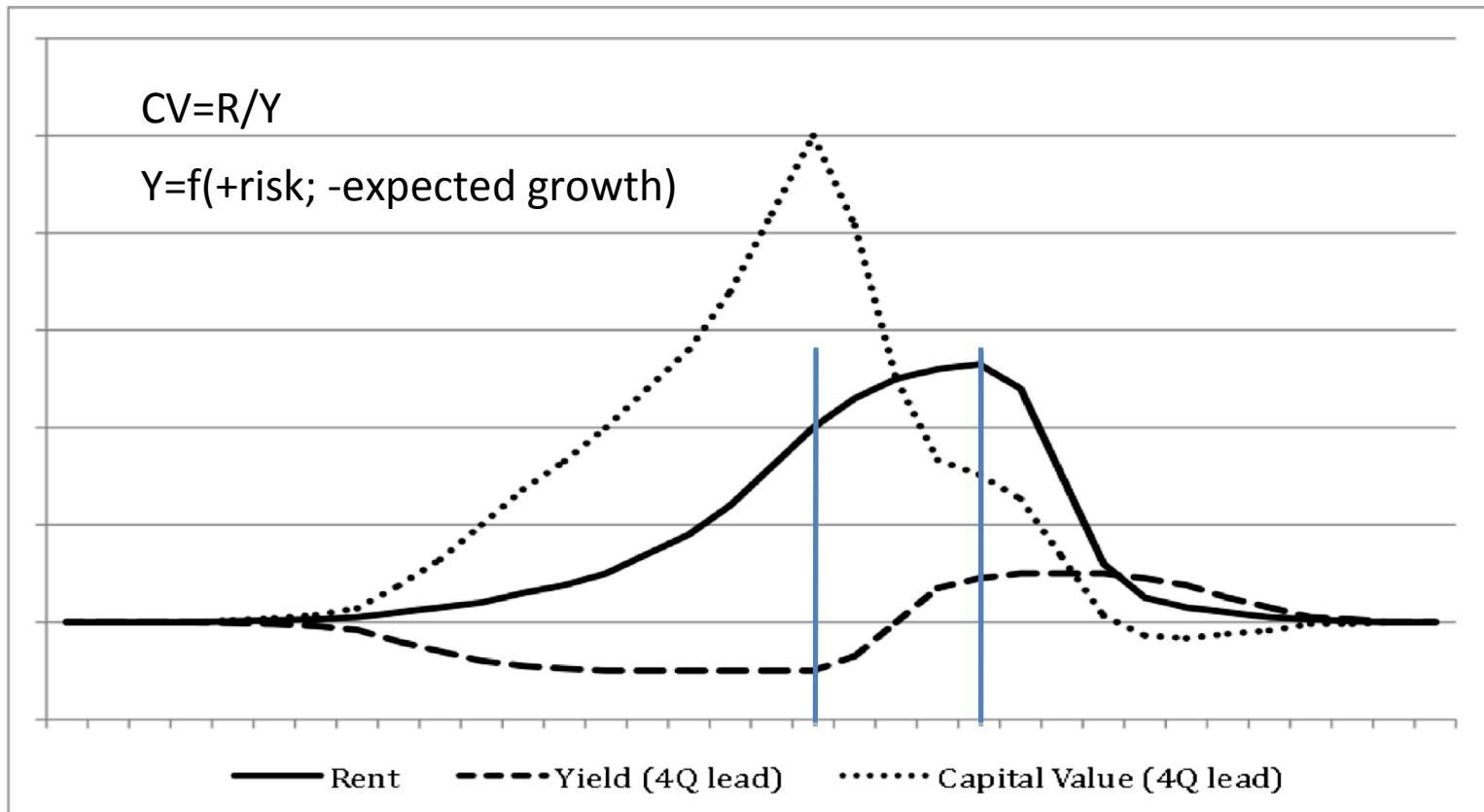
*“The industry is restricting itself and altering the UK property market, by affecting the markets in which it invests, for example London. The benchmark has a much greater effect on the markets that we do not invest in, it has implications for their ability to compete and the growth of the markets are hampered by the over subscription to the benchmark.”*  
(Director, Global investment management company)

# The effects of benchmarking

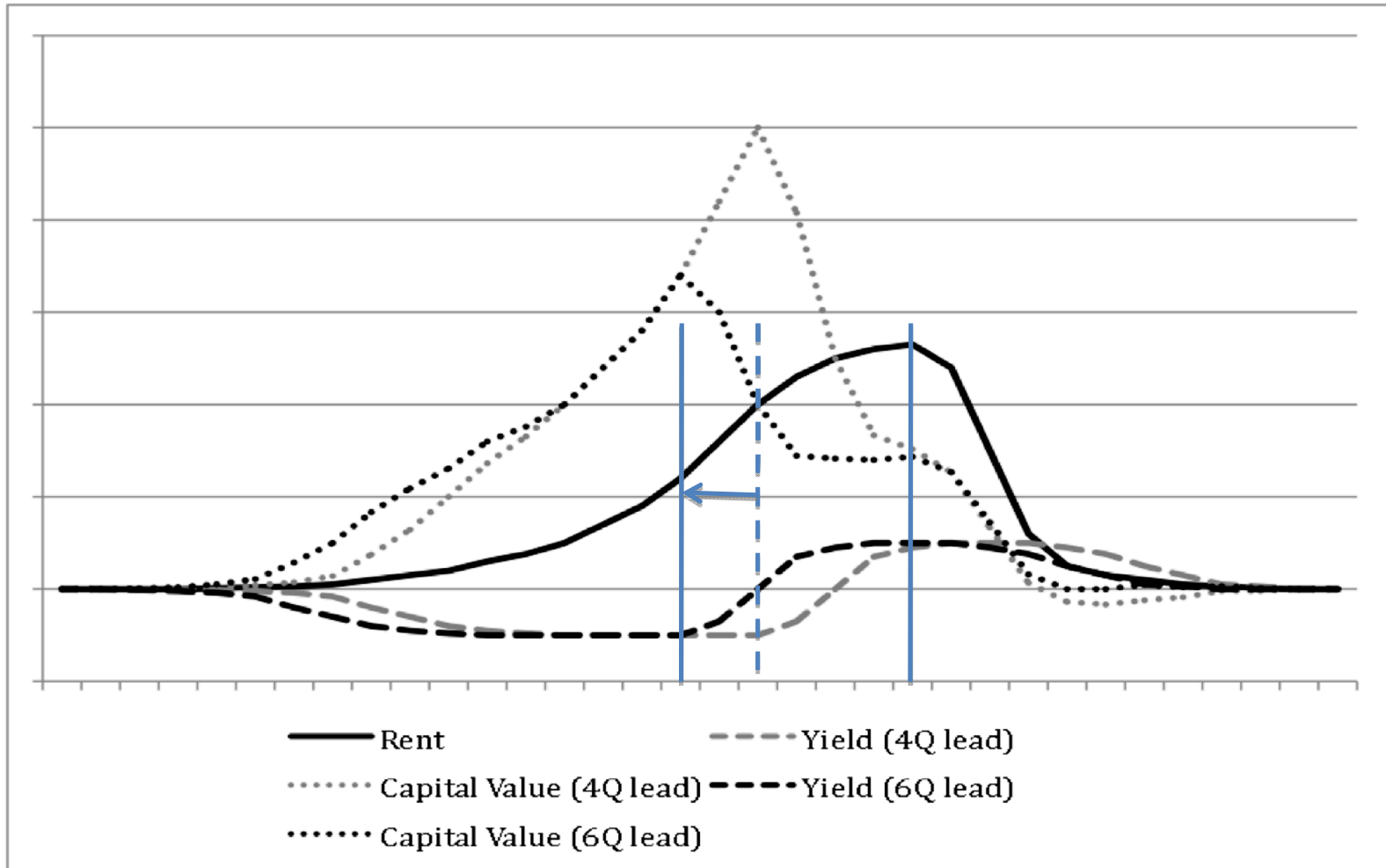
“ Expunging from funds any assets other than ‘normal’ or ‘average’ ones results in uniformity and rigidity in fund structure and the concentration of performance around a bounded range of sub-optimal returns. As a result, the funds will not lose customers and their managers will not lose their jobs (but the customers may well lose their shirts).

# Influences on Urban Property Markets: *Rent and Yield Cycles*

A Stylised Representation of Rent, Yield and Capital Value Cycles



# Influences on Urban Property Markets: *Rent and Yield Cycles*



# Influences on Urban Property Markets: *Rent and Yield Cycles*

- “ Long yield leads reduce market volatility and produce property booms that are less marked and of shorter duration.
- “ Yield leads are directly related to regional peripherality and inversely related to position in the urban hierarchy (because of the pattern of economic linkages/transmission of shocks)

## Influences on Urban Property Markets: *Lot Size*

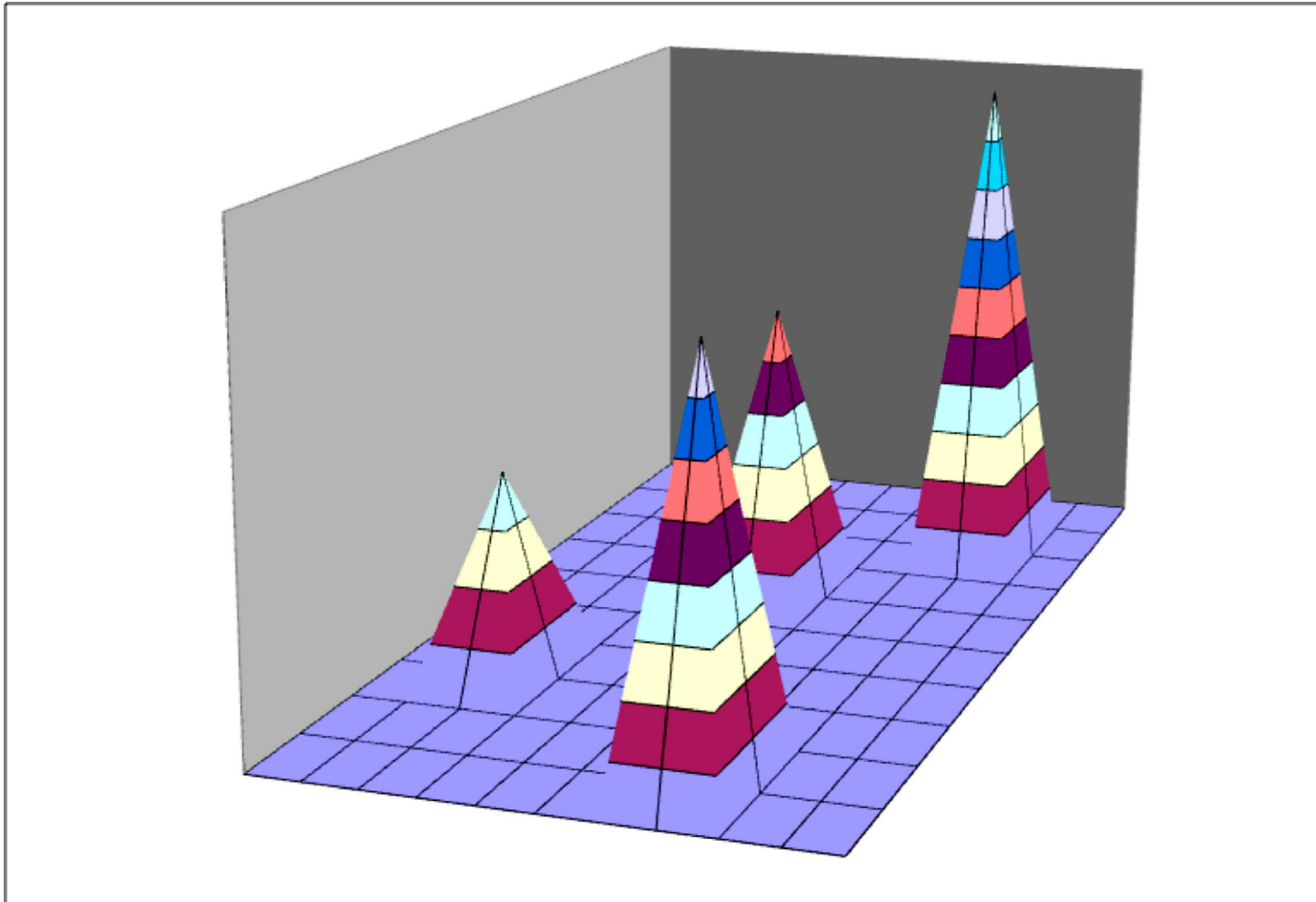
*“...If we were offered a £10m building in Manchester we probably wouldn’t look at it because it is £10m.... We don’t really want to dilute our value per property. If we want to grow we want to grow bigger by buying big buildings. We can’t afford to buy 100 properties of £1m each, it is not cost effective.” (Property company)*

## Influences on Urban Property Markets: *Lot Size*

” *“What we have therefore embarked upon as have a number of the other property companies is a strategy which focuses on creating dominating centres. It is very much to the detriment of the smaller peripheral sub-regional centres. What we are doing is off-loading the small, more management intensive properties in the lesser towns if you like, where we have to put an awful lot of effort in to get smaller returns and [moving] into towns where we know we will get good rental growth and that is really the whole raison d’être...”* (Property company)

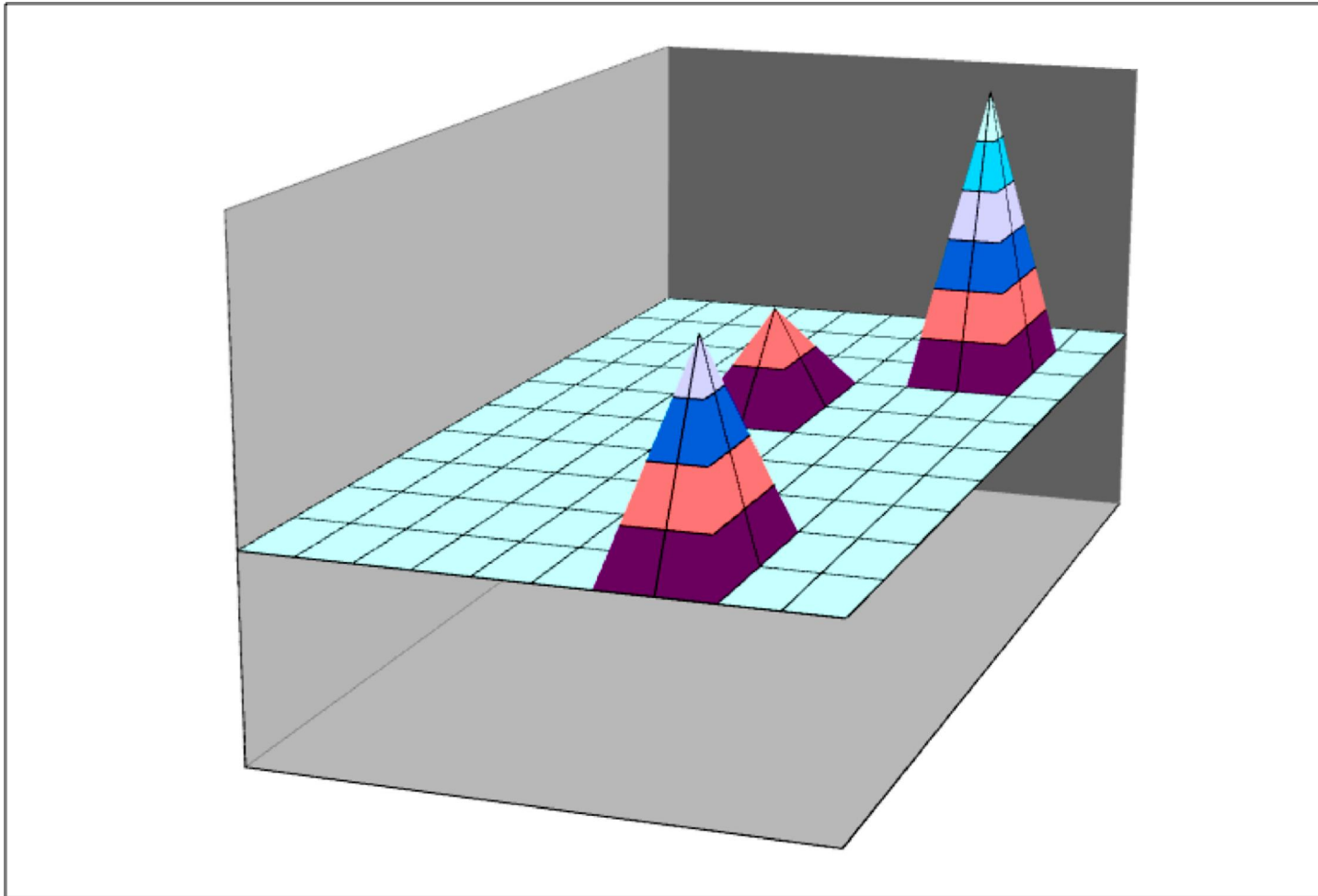
# Internal Influences on Urban Property Markets

## Cities and Their Building Stocks



# Internal Influences on Urban Property Markets

## What Institutional Investors 'See'



## External Influences on Urban Property Markets

“They have approached (development) with what I would call a London way with very little relevance to local property markets and very little understanding of what’s actually going on here ... whilst price is important there are equally important factors such as the cultural activities of the city, such as the ability for employees to live and work in the city, such as the ability to walk to a sandwich shop and enjoy a decent quality of life and all those aspects the main stream surveying profession singularly fails to recognise and yet are absolutely fundamental to rental growth ... and what pisses me off is that they (institutions) have to go back to their facts and figures and rationalise it to their shareholders.” (local developer)

## Internal Influences on Urban Property Markets

- “ National developers have superior financial resources and adopt a very cautious approach to operations in what, in their eyes, are the relatively weak property markets of medium-sized cities.
- “ Local developers are more involved in speculative activity in their own, well-known 'back-yard'. Their pursuit of development is marked by speed, flexibility and opportunism – but not always by sophistication.
- “ "... local developers appear[ed] more likely to see a scheme through to completion than national or international developers" (Antwi et al, 1993, page 28)

## Internal Influences on Urban Property Markets

- ” *“If I was them (the local authority) I would be running up ... saying ‘Come on, what more can we do? Let’s work together, let’s get more done.’ Whereas in reality every time I went to them for funding it was ‘yeah right’ as if they would rather have a developer they didn’t know coming in.”*  
(local developer)
- ” *“... go away and formulate ways in which you can work with the local property market, with the local entrepreneur because that’s where the real innovation and freedom comes from.”* (local developer).

# Possible ways to remove barriers

- “ Investment yields and lot sizes: target regional investors and developers that have a better perception of relevant urban property markets and operate at a smaller scale.
- “ Lot sizes: use of a REIT (Real Estate Investment Trust) to aggregate small units.
- “ Internal influences: creation of media through which locally active property developers and investors and local authorities and others involved in local governance can engage for mutual benefit.