Agents and functions in urban development: frameworks for analysis

This was presented at the University of Las Palmas, Gran Canaria, at the invitation of Eduardo Caceres. It was published in Spanish, with an English parallel text, as Edwards, M (1995) 'Agentes e funciones en el desarollo urbano' Cartas Urbanas *4: 26-39*

Aim and Scope
The aim of this paper is to provide an informative view of the economic processes involved in the process of **development** of urban land and buildings.

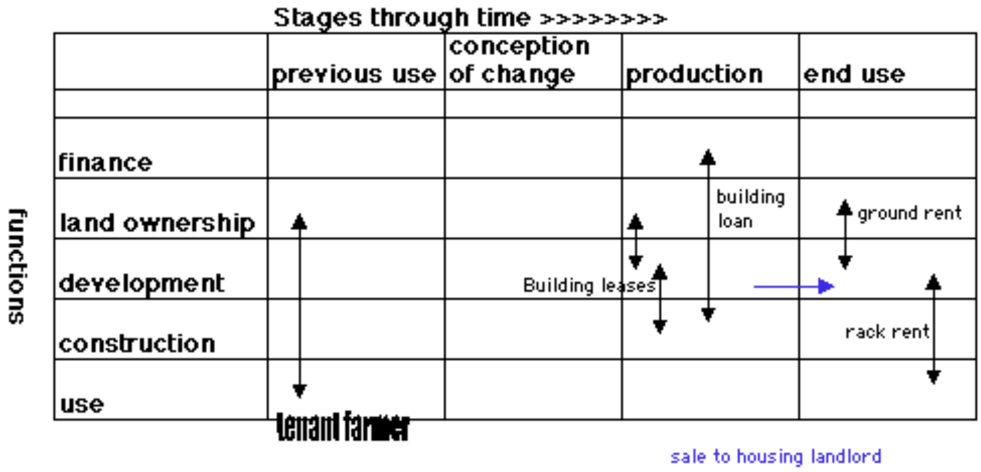
Agents or functions
It is very common to read about the "agents" or about the "players" in urban development: land owners, banks, tenants, builders and so on. They are easy to identify in any project. It is common for critics of architecture and urbanism to "blame" particular agents for faults in what gets built.

However, for two reasons I want to write instead about **"functions"** - for example credit and investment, building production, consumption and use. These reasons are:
(a) The main functions in urban development **always** have to be performed, while particular kinds of agents may be absent in a particular case - for example we don't always find banks; we often now don't find a distinctive class of land owners;
(b) The functions may be performed by a single agent or by a lot of separate ones and it is useful to look at these different **organisational forms** as important in themselves - for example we may find vertical integration where one organisation combines all functions.

The particular approach used here draws principally upon research by Topalov, Harvey, Ball, Chambert and participants in the Bartlett International Summer Schools on the Production of the Built Environment. The diagrammatic summary is due in particular to Chambert, whose work on Stockholm and Sweden will soon be published. A short bibliography is at the end - unfortunately mostly in English.

The basic approach here is to think of the whole long life of buildings and the land they stand on in a capitalist economy.

Think of a sequence in the course of a development project:



This diagram happens to have been drawn to illustrate the relationships associated with leasehold development in London in the 18th / 19th centuries, but using a framework essentially derived from Chambert; see also Page.

A. Land starts in one sort of **previous use** (perhaps a farm, a factory);

B. For some reason there are then actions which are the necessary preparation for development or change of use. This **transitional** or **mediating** stage can involve the land changing hands, it can involve technical design work, legal work about permissions, political activity, the arrangement of grants, subsidies, investments and loans: everything necessary for the project then to go ahead.

C. Actual **production**: engineering, building and so on.

D. When the work is physically complete it is not yet economically "complete": until it is sold and the money received, the payment of those involved so far cannot be completed and the accumulation of capital stops. New owners or users must be found. Thus begins a stage of **use** - the (usually long) life of the finished project, but still with a stream of investments in maintenance, repair and adaptation.

Finance
All four stages of our simple model may involve finance, i.e. there may be people who have invested money capital either as shareholders or partners, or as interest-bearing loans. In principle this role is simple to describe but in practice it can be very complex, and the forms which investment in real estate take are becoming endlessly more elaborate.

Finance phase by phase
In terms of the four stages:

A. Since we are interested in the development process we may not need to know much about the financing of pre-development activity. But it can be important in triggering development: the farmer, in debt to the bank, paying rising interest rates from a falling income, may be forced to sell or to develop. This man or woman has actually been a common phenomenon in many parts of Europe.

B. The transitional phase of getting projects ready is often carried on with the owner's or promoter's own money. It is a risky stage (because of uncertainty about permission and/or about market demand). The attitude and involvement of the state can be very important here in determining the level of risk, creating general conditions such as the supply of infrasructure.

C. Actual production is always very costly and is hardly ever feasible without some sort of loan or equity finance coming from outside the organisation promoting the work. [The common exception is in self-build housing where the household builds a bit each year - just what it can afford from its income.] The financing of urban development is a very important kind of asset for the world's banks and investors. It can be very risky, depending principally on whether the project is commissioned or speculative and, if it is speculative, what the demand conditions are likely to be.

D. When a building is finished the promoter may simply sell it, using the money to pay off any debts and ending up with a profit or a loss. But that can only happen if a buyer can be found who has (or can borrow) the money to finance the purchase. So in principle the credit problem is a continuing one in to the future. We find in many countries that particular kinds of financial institutions (e.g. pension funds, insurance companies) specialise in the long-term ownership of real estate as investments; other institutions may specialise in long-term finance (loans) for housing, for industries, etc. In some places there are strong regional banks which can be very important - e.g. in Italy. In the UK the specialised and localised banks have almost disappeared now though there is no sign that the huge general-purpose banks are particularly good at making decisions and using their huge market power in anyone's interests.

The degree of power and influence of the lenders and investors can vary enormously from case to case, and can change very fast. Often we see that property development or investment companies have debts to the bank which seem quite modest and the interest can easily be paid out of rental income or building sales. But then if building rents fall or if interest rates rise (or both) the company can quickly be weakened or destroyed and the banks and creditors end up owning a lot of (devalued) buildings. This is what happened to Olympia and York, the world's biggest promoter, and to many others last year. The power relations can shift.

In a world where money capital can flow increasingly freely - not just in Europe but globally - the capital markets can channel very large sums in to and out of the real estate sector, as we have seen in the late 1980s. A sudden rush of money can drive prices up. Investors confront special problems when they try rapidly to withdraw from real estate: real estate assets quickly become rather illiquid when everyone is trying to sell and a dramatic fall of values can easily be precipitated. I think it is fair to say that today's international markets in real estate assets are very volatile and not at all self-regulated.

Land ownership; promotion (= development)

Historically the ownership of land has been an enormous problem for the development of capitalist economies - often presenting great barriers to modernisation, inhibiting investment, using local monopoly powers to suck out of local economies income which could otherwise have been used for productive investment. Sometimes the mere structure of ownership (small plots, complicated tenure) could prevent owners from developing easily, even when they wanted to. Occasionally there have been cases where forms of large-scale private land ownership have enormously simplified and helped development but the general rule is that landownership is a barrier.

In modern Europe we have seen changes which - to very varying degrees - have removed some of these barriers, usually by giving the state powers to acquire land and to service it for development, or to re-parcel sites, or to acquire land if the existing owners do not develop it in the way (and at the time) required by some plan. The Netherlands and Spain seem to be rather advanced in this process, Britain rather behind.

While the land ownership system may vary from country to country, there is always some development or promotion function involved in any urban project. This may be a very simple function - as where a municipality builds its own school or a manufacturing firm builds its own factory extension.

But it can be quite a demanding and complex function, potentially including:

- conceiving of the possibility;
- finding a location;
- market research (for speculative projects) or consultations with future users, and feasibility studies;
- specifying the product, commissioning designers;
- obtaining permissions;
- finding investors, credit, state subsidies;
- contracting with, and controlling, builders;
- marketing the finished product in advance;

and often doing all these things fast - to minimise interest charges or (if the project is speculative) to catch what is thought to be a good price in the market.

[The **agents** which perform these functions vary enormously. Some industrial firms do it for themselves. Some banks and insurance companies have their own development divisions. Sometimes there are integrated firms which combine construction, promotion (and often finance too) as in France and Japan for example. Sometimes promoters become also property investment companies, holding on to their completed projects and becoming large scale managers as well as producers. And then there are the pure promoters - often very small firms with few staff and little capital - who specialise completely in getting projects together, completing them, selling and going on to the next. This could be the small speculator who builds one house a year or a large-scale operator like some development companies in the UK.]

Remember too that promoters / developers may be the same organisations as land owners or may be quite distinct and this may have profound effects on what gets built and on the flows of money and risk involved.

Perhaps the most important distinction to make here is between development which is speculative or not: speculative production is where, at the time when construction starts, there is no particular user of the building contracted to use it.

In some places speculative development is the dominant form; in others most building is done by or for clearly-identified users. This distinction often corresponds with the distiction between owner-occupation and renting of finished buildings discussed below under "use".

But it is potentially a very important distinction for the location and for the design of buildings because speculative developers will tend to produce buildings of the type and location which **they think** will sell. They may be wrong so some buildings are under-used while people seeking buildings in some types and places may not get them. Also they may tend (with a few brave exceptions) to play safe - to **congregate** on the types, designs and locations for which they think there will be a steady mass of demand. In this case marginal locations will be under-supplied and unusual kinds of building will not be built.

Production itself
The construction process needs rather little description: we all know what it is. But we should remember that

- the final assembly of buildings on site is a decreasing proportion of value added: for every worker on site there are others making components, materials, equipment, tools and getting them designed, transported, insured and so on. Counting all these linked processes we are considering a big part of the modern economy.

- there are remarkable national and regional differences in this industry: in how labour is trained, in levels of productivity, in quality of work. The early stages of the Single Market may be opening up big public projects to international tendering but it will be a long time before we have anything like a homogeneous building industry in Europe.

There are some important changes in the role of the professionals within the production process. For decades the model in the UK and elsewhere has been that the architect (or engineer) designs. Then builders are found to build. It is the tradition of the liberal professional.

Imagine Nissan or Sony working this way! They want to integrate design and production for speed, for effective learning and feedback and for cost control. Similarly in construction in leading sectors we are beginning to see in the UK the arrival of American and Japanese approaches in which the building contractor or a construction manager takes control of the whole design-and-build process. The architect becomes a servant of the builder. If there is a distinct design firm it may only be involved at the early stage of getting permission and later as a sub-contractor to the main contractor. Thus the architectural and other professions are being placed under great pressure in a new social division of labour.

Consumption and Use
The simple form of consumption and use is owner-occupation.

For housing this is the dominant form in many societies and (with elaborate credit arrangements) is becoming dominant in Europe. For industrial and commercial buildings it is also very common for firms to own their own buildings - either getting them built to their requirement or buying them from others. Credit may be involved in this. But often it seems to be the fact that real estate can be good security for borrowing which makes this form of tenure attractive to businesses: they can borrow against the security of their land and buildings - to raise capital for any business purpose, not only to buy the real estate itself. A second advantage may be that the firm can get exactly the building it requires - rather than having to buy what the market offers. A third advantage may be that the firm is insulated from the effect of changing rents.

Owner-occupation of factories, offices and shops is dominant in Germany, Holland and many other parts of Europe. We don't really understand why yet.

Alternatively there are many forms of tenancy. This means that some landlord or investor retains some of the rights of ownership in the land or in the land+buildings and collects a rent in exchange for giving a tenant the rights of occupation. The details vary enormously from country to country and there is absolutely no European harmonisation.

This rental system has been dominant in the USA and UK and there are those who believe that it will spread through Europe.

When a rental system exists we get two distinct markets:
(a) a **user market** in which users compete with each other to rent the available space. This supply-demand interaction determines the level of rent in each place and rents can be very volatile since demand changes much more rapidly than supply.
(b) an **investment market** in which investors compete with each other to buy the available buildings (occupied or empty) to use as investments in order to gain the flow of rent from them and the hope of capital gain. In these markets capital values are determined. Capital values depend of course on levels of rent (more rent, more value), but also on expectations of future rental growth, on expectations about future lettability and on the returns available in other kinds of investment[1]. (Investors will not buy buildings which yield less than bank deposits or government bonds unless there are strong compensations like the prospect of future growth.)

From the point of view of construction this means that it is the fluctuation of investors' demands which mainly determines the quantity of building. We can and do get enormous fluctuations in building production and these are only influenced by fluctuation in the actual demand (from users for buildings) in a very indirect and inefficent way, and with some years of delay. In the UK where this system predominates, investors' optimism and herd instinct in the 1980s seems to have fuelled orgies of competitive bidding for properties and thus generated over-production of buildings for the investment market on a scale which will not be validated by final demand in the uder markets[2]. It seems very inefficient and it is certainly very damaging to the development of skills and capacities in the construction sector.

On the other hand, the existence of big rental markets is said to be good for the efficiency of firms which use space. They have a choice of where to locate and about the quality and quantity of space they occupy: it is very flexible for them. It also frees their money capital for use in the business and helps new firms who lack the capital to buy or build.

It is an open debate with little hard evidence. The precise configuration of rights and duties within leases is all-important in determining the distribution of benefits between the parties over time.

A further interesting question is the effect on architectural design, location and working conditions inside buildings. Since this is more a question of how buildings are developed than a question of how they are finally owned it is discussed above under "Promotion".

Certainly, however, the existence of dual (investment and user) markets is liable to mean…

- that the link between supply and demand becomes very indirect. This is bad for equilibrium and bad for the flow of "information" through which markets are supposed to ensure that user needs are sensitively met;
- that a limited number of standardised commodity types emerge because investment markets

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1 In the jargon of the UK markets, we define a term "yield".

$$\text{Yield} = \frac{\text{current rent} \quad \times 100}{\text{capital value}} \%$$

2 The situations in Japan and the USA where the invstmnemt markets are also strong, appear to have some similar features.

are best at handling standardised commodities, and this may reduce the diversity of what gets built.

The kinds of relationships governing production
The 16 boxes in the table are functions being performed. Sometimes more than one agency is involved in a box (e.g. contractor and sub-contractor; land owner and promoter). So there may be lots of agents. What is often important is the relationship between the agents. These relationships can take many forms. Principally…

- Contracts for work (between promoters and builders, architects, engineers)
- Rents / tenancy relations
- Interest on borrowed money, profits on shares
- Outright purchases and sales.

All these contracts represent important social and economic relations. They can be very tense. Their content can change with time (as in the example earlier where manageable bank interest becomes burdensome and the bank gains in power).

A very important issue arises. Some production processes involve sustained inter-dependence of various functions and agents. For example the massive social housing programmes of social democratic governments through the 60s and 70s were based formally on state expenditure and have often been criticised as damaging to the private sector of the economy. But in fact they always involved very substantial and risk-free opportunities for private agents in construction and in credit (Chambert, Ball) and the more market-based housing forms which have replaced them tend to be more risky and less certain for the private agents.

The general conclusion is that we have to try to understand the interactions of the system as a whole.

The state: present everywhere
So far it has been a story of private agents interacting with each other.

Conventional neo-classical economics tends to analyse these relationships and markets and then consider whether there is any state "intervention". There is a presumption that any state intervention will tend to "distort" market relationships and reduce the efficiency of the markets in allocating resources and regulating production.

This is a fundamentally wrong way of seeing it.

Really the state (national and local government and all the public bodies) are centrally important in constituting and regulating all the relationships and functions shown in the Chambert table. The state acts…

- As guarantor of general exchange through the laws of contract and the courts;
- As fixing taxes, subsidies and thus the 'terms of trade" among all those involved;
- As a provider of the infrastructure which enables land to be used;
- As making plans, granting permissions / regulating risk;
- As assembling land or re-organisaing ownerships;
- As an investor, as a user of land and buildings, as rescuer of failed projects.

Prospects for the future
Does the Single European Market mean convergence or homogenisation

- of product?
- of development forms?
- of levels of living?
- or is there a danger that it institutionalises disparity??

What special challenges confront the built environment professionals?

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Netherlands – Needham
Sweden – Mattson
Italy - Ave and Corsico

Funding mixed use schemes

Commissioned for a seminar on 'Investment in the Community' by Stanhope Developments Ltd in 1989, organised by Ziona Strelitz. Minor editing 1995.
This starts off as a talk, introducing discussion, and then becomes a record of the discussion. The group included professionals from architecture, planning, development surveying, valuation, pension funds and property development. A number of local community activists were also involved.

In addressing a discussion on funding mixed development, we must recognise that our approach to the topic is impeded both by poor research and by a lack of systematic expertise.

What is the issue? Casual experience suggests that the extensive single-use areas characteristic of post-war development are highly unpopular from the Royal Family outwards. This resistance is expressed against large uniform areas for all types of activity, including cultural centres like the South Bank, just as it is against large office zones and shopping centres where you can do nothing but be an office worker or shop.

What mixtures are we talking about?
- mixtures of rentable uses: offices, shops, industry, housing
- mixtures of rentable and non commercial activity: lavatories, parks, libraries, churches, sports, crèches, community halls.

The main focus of the discussion should be on mixing only revenue-generating activities. That's difficult enough to start with. There are considerable problems integrating, say, housing, offices and shops and organising funding for these.

Why are uses segregated?
Can we scrutinise segregation without preconceptions in terms of four sources of trouble - each of which may be substantial or a myth?

Environmental interference
The old planning logic for zoning was largely based on "negative externality" eg: keep residences away from noxious industry; keep heavy trucking away from schools.

However, much separation of uses is based on 1920's assumptions about the characteristics of activities which are now invalid. The mechanical and electrical servicing machinery for offices now makes them noisy users. Large trucks which service small "local" shops in the middle of the night for cost optimisation also cause disturbance. Conversely, on the industrial front there is no more glue boiling.

Given the characteristics of contemporary activities what are the continuing environmental grounds for segregation? How can these grounds be expressed in regulations without relying on “use classes”?

Technical incompatibility
This is largely a problem of mixing uses within a single building. There may be incompatible requirements regarding building depth and lighting; access (routes, timing and security); noise and disturbance associated with refurbishment on different cycles when eg. housing, shopping and car parks are involved in single structures.

Funding problems (our main theme)
A vastly diverse range of human activity is accommodated nowadays in a ludicrously narrow range of building types: offices, shops, industrial buildings, science parks, housing. Property markets are separately structured for each category and each category becomes more and more standardised.

Can we test the hypothesis that single-use developments are preferred by funding institutions because they find pure commodities easiest to deal with and mixed ones inconvenient? Is property segmentation linked to institutional inertia simply because the groups of people dealing with each property type are separate?

Professionals conduct the financial appraisals on large developments by working separately though each component, in isolation and independently of each other. They do not have a forecasting model for valuation in which the interdependencies are shown. The benefits of interdependent uses are lost from the estimates by the way the calculations are made.

The rates of return from different elements in mixed use development are very different, usually. Most projects have a leading use which tends to squeeze the others out, especially if a land price based on the lead use has already been paid or promised. Is this a good way of proceeding? Clearly not.

User preferences We have all met the shopkeeper who says "there's no call for it" and we know that it's often a limp excuse.

Can the uniformity of single-use developments be validly defended on grounds of user preferences? The answer may depend on whom the users are seen as being- the firm which takes a tenancy or the workers and customers of that firm or the wider society. At least three categories of user matter in this:

- the investment market
- the preferences and demands of tenant organisations
- end-users themselves

Looking to Europe and elsewhere, if we identify the issues, we must look at precedents of good practice elsewhere. We have a very localised situation nationally. The implications of European integration for this are radical.

Are markets equally homogeneous in Europe? The higher level of owner occupation of work premises in much of Europe creates very different conditions. There may be less flexibility in meeting the tenancy needs of firms, but the capability of producing a more heterogeneous building stock is clear.

Could it be said that the British investment market in real estate is the main impediment to mixed-used development?

Personal caveats (interjection by workshop convenor) By having discussions like this seminar, it is easy to form the impression that there is consensus in the wider society. This is often not so. In property-led urban regeneration, there have so far been gainers and losers. Talking does not eradicate this.

Divergent experience and points of view. The workshop discussion was characterised by these.

South East vs north of Watford
Organisations that are strong enough can make their own markets in the regions. They can find the space and the costs of doing schemes. For others this is a problem that affects the mixed element of schemes.

One view was that the "gap finance" requirement is not necessarily greater in the north, only that there is less total margin in which to manoeuvre. The view from the Black Country, however, is that a large proportion of urban renewal costs has to address problems below ground. 'One is into gap funding immediately.' One surveyor's view is that "you're in trouble before you've started on made up land".

Old or prospective market values An ingredient of the North/South difference relates to whether one derives property values from - the old or the prospective market situation.

Roles of state, public and private agencies
Clearly all problems cannot be solved by the property development sector. Other mechanisms are

needed. However, the property development sector does need state interventions of various kinds to get on with its business. A developer needs confidence in the infrastructure prospects, in the regional economy and in what may be permitted - to itself and to its competitors.

Funding large vs small-scale schemes
Different conditions pertain to smaller projects. They are market-takers, not -makers. Fewer externalities can be internalised within a small scheme. Bloomsbury and Regent's Park are good examples of schemes large enough to internalise for the developer the benefits created by the green space; Foster's plan for King's Cross is the same. Small projects simply cannot do this. And their funding road is harder than for large operations and big acreage.

Small projects especially are more dependent on an environment created by plans, infrastructure and zoning flexibility. Planning systems (currently government supported) constrain flexibility.

Appraising value of mixed use
Investment appraisals are considered in discrete categories for separate use types. Each category is difficult in itself. It is hard to merge these appraisal techniques, although a valuer would amalgamate the income at the end of the day.

However, as one creates places by mixed use development, one should combine uses at the outset and value comprehensively on day one. This is hard without precedents on which to operate.

Valuers admit that they don't know how to reflect the effects of mixtures in the valuation of the separate scheme components. There is a research problem here if current practice is to be up to the job.

- Professional and technical problems: separate valuations on different mixed use elements are not helpful.
- Comprehensive evaluation judgements are not well developed.

Knowledge on this is limited. Research is required.

Evaluating benefits The elements of a typical scheme may include for example:
- housing for sale
- social housing
- leisure
- commercial rentals

The aim often seems to be creating a place where people come 24 hours a day. Is this really right everywhere?

Can one quantify the user benefit of such a scheme, beyond reporting that users like it?

Horizontal versus vertical mix
What are the relative benefits of horizontal or vertical mix of uses?

One view is that horizontal mix is easy in funding terms, whilst it is difficult to find funding packages for vertical mix.

Other experience indicate that lateral (ie. horizontal) mix of uses is a problem because of different objectives and difficulty in maintaining control of the whole. Some consider that financing lateral mix is out of the question (JLW).

Community involvement in heterogeneous development.

The value of heterogeneity is often not recognised, as evidenced by planners in a London borough insisting that one single architect be responsible for 3.5 acres of development.

On an urbanistic level, the lateral mix is important. Development must be diverse and give scope to many small institutions alongside large institutions.

The approach to large scale development thus far seems to ignore community involvement. Some consider that mixed development must include "community sweat equity".

Room must be allowed for some development led jointly by residents and developers; not all development should be developer-led. The latter does not produce an atmosphere to generate the growth that financial managers should seek.

Effects of scale again
Ability to fund mixed use is affected by scale. There are economies of scale and impact in financing large projects, with room in the financing to cope with aspects of mixed use. In smaller schemes it is harder to cope with mixed uses when funding.

However, the concept of large scale "can be very frightening for local people". A multiplicity of small uses is the real nub of what makes the inner city successful.

Financial difficulty arises with small scale schemes because people's minds become very focused on the income generated from the various bits.

Whilst affirming the feasibility of funding mixed schemes, Stanhope recognise that small projects by small firms face a different situation.

Therefore one should create a large scale effect by putting together several small projects, as in the Inner City Enterprises portfolio, or the group mortgage secured from a building society by a number of residents at Lightmoor.

Perhaps a group of insurers to insure group portfolios should be arranged. This is a mechanism for funding individual projects.

Scale and timescales There is also a scale issue relating to timescales. Local authorities who put land into a scheme want quick returns. They have very short timescales on their own funding problems (typically a year) and then the prospect of an election.

The difficulty is in balancing long term capital gain and up front returns to satisfy impatient local authorities.

Timescale is a major factor in developing mixed use schemes in unproven locations. A lead time of 3 years rather than 18 months was suggested for a £2 million scheme. By creating larger scale, one may be able to move faster.