Keeping wealth local

Josh Ryan-Collins

How we can use Urban Wealth Funds to unlock spending and drive local economic development and housing affordability

The government's October budget saw a welcome real-terms increase in local authority funding of £4.8 billion over three years. However, following a decade of 40 per cent cuts in non-statutory services, the new funding will not return council budgets to anywhere near their 2010 levels. Indeed, the Covid-19 pandemic has seen huge pressures on council budgets, with business rates, council tax and transport incomes being further squeezed by local and national lockdowns just as the demand on local public health and social care budgets has been driven up. At the same time, house prices have risen to record levels in the UK during the pandemic and, outside London, private rents are rising at their fastest rate for 13 years.[1]

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Could there be a solution – not dependent on central government – that addresses both challenges? We are used to thinking about the public sector and public services as a cost to society, with constant media attention on rising public deficits at both national and local levels. But the public sector also has 'assets'. In particular, it owns large amounts of real estate: such as the land and buildings making up schools, hospitals, railways, council houses, ports, airports, and water and electric utilities. The non-financial

1 Jones R (2021) 'Rents outside London soaring at fastest rate on record, agencies say', *Guardian*, 8 September 2021. https://www.theguardian.com/business/2021/sep/08/rents-outside-london-soaring-at-fastest-rate-on-record-agencies-say

assets of local government, excluding council housing, were estimated to be almost £400 billion in 2019, amounting to around 18 per cent of GDP.[2]

Since the 1980s, the default assumption has been the best way to monetise such assets is to sell them. Since 1979, the UK government has privatised around half of its real estate portfolio, equating to some 2 million hectares of land, or 10 per cent of Britain.[3] It is by far the largest element of Britain's privatisation programme, dwarfing the much better-known sale of council housing in the 1980s. Even allowing for inflation, most estimates suggest the public sector did not realise anything close to current value from the sales. One recent example: according to a National Audit Office report,[4] the government lost up to £4.2 billion after selling off 55,000 homes for military families to Terra Firma, a private equity firm. Since land in the UK has consistently grown in value at a faster rate than either capital stock or income over the past 30 years,[5] selling it off makes little long-term sense for the public sector.

The dominance of neoliberal ideology is clearly a driver of real estate privatisation, one that the current government may be less enamoured of given recent nationalisations in the railway network. However, there are also more prosaic explanations. Most obviously, public sector assets are normally not mapped and accounted for at all in financial terms, or, if they are, they are valued at their historical book value, rather than their current market value. Instead 'cash accounting' is dominant, whereby public sector balance sheets are reduced to representing present revenues and expenditures only. Buildings in city centres that if carefully managed could generate significant flows of income and be leveraged to borrow for investment are instead viewed primarily as drains on the public purse due to ongoing maintenance costs. This distorts incentives and decisions for politicians towards privatisations. Incorporating the potential financial value of such assets – 'accrual' accounting' – is recommended by

2 Office for National Statistics [ONS] (2020) 'National balance sheet estimates for the UK: 2020'. https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/bulletins/nationalbalancesheet/2020

3 Christophers B (2020) *The New Enclosure: The Appropriation of Public Land in Neoliberal Britain*, Verso

4 Watt H (2018) 'MoD lost up to £4.2bn through sale of military homes, says audit office', *Guardian*, 30 January 2018. https://www.theguardian.com/uk-news/2018/jan/30/mod-lost-up-to-42bn-through-sale-of-military-homes-says-audit-office

5 Office for National Statistics [ONS] (2020) 'National balance sheet estimates for the UK: 2020'. https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/bulletins/nationalbalancesheet/2020

international accounting conventions such as the International Financial Reporting Standards (IFRS) and is standard in the private sector. Doing so would reveal the potential goldmine many councils or regional authorities are sitting on.

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Realising such income will likely require new kinds of governance and institutions. Very low interest rates encouraged local authorities to engage in a near £7 billion commercial real estate (CRE) splurge in the run-up to Covid-19, but councils are ill-equipped to manage these kinds of projects. Collapses in CRE values due to lockdowns have landed some councils in financial trouble and led the Treasury to put the brakes on such borrowing.[6]

An alternative approach – featured in a report published last year by the UCL Institute for Innovation and Public Purpose[7] – proposes that local governments could consider aggregating their substantial real estate assets into 'Urban Wealth Funds' (UWFs) to support recovery from Covid-19.

First proposed by Swedish economists Dag Detter and Stefan Holster (also co-authors of the IIPP report) in their 2017 book *The Public Wealth of Cities*,[8] UWFs are wholly publicly owned but politically independent holding companies operating with strict corporate governance standards. A UWF would exert active governance of the assets they own, usually in their own jurisdiction for the purpose of maximising value for the local or regional public sector. Internationally UWFs have been effective vehicles for developing real estate and ensuring the rise in land values that comes from public investment in infrastructure, in particular transport, is

6 Hammond G and Pickard J (2020) 'Treasury set to curb property investments by councils', *Financial Times*, 20 May 2020, https://www.ft.com/content/d68e46f9-2f13-465f-beb3-466c4f2d8530

7 Detter D, Folster S and Ryan-Collins J (2020) 'Public Wealth Funds: Supporting economic recovery and sustainable growth', Policy Report WP 2020-16, UCL Institute for Innovation and Public Purpose. https://www.ucl.ac.uk/bartlett/public-purpose/publications/2020/nov/public-wealth-funds-supporting-economic-recovery-and-sustainable-growth-0

8 Detter D and Folster S (2017) *The Public Wealth of Cities*. Brookings Institution

captured by the public purse rather than leaking out to a small number of private landowners, private developers or corporations.

One of the best-known examples is Hong Kong's MTR (Mass Transit Railway of Hong Kong), which develops real estate in order to fund subway construction. MTR's strategy has been to acquire land at pre-development prices and then sell or lease the land at development prices upon completion of the new infrastructure – thereby capturing the land rent itself. MTR has financed and managed not only vast investment in the city's rail infrastructure but also a number of large housing estates and shopping complexes incorporated into its stations. MTR pays a substantial dividend to the city, providing an income for the government that has been deployed to pay off existing debt and develop other assets. Today it is one of the most profitable railway systems in the world, while ticket prices are low by world standards.

Copenhagen and Hamburg have developed substantial parts of their cities without using tax revenues from central government using UWFs. Under the auspice of the UWF, the 'HafenCity Hamburg Gmbh' holding company has redeveloped Hamburg's old harbour – a 2.4 square-kilometre large inner-city district – for 7,000 residential units and offices for some 35,000 people, while it payed for schools, universities and kindergartens, as well as a landmark concert hall. Copenhagen also developed an old harbour, as well as an old military garrison in the city centre. With a total area of 5 square-kilometres, 'By og Havn I/S' (City and Port) is the largest UWF and urban development project in Europe and has resulted in more than 33,000 new residential housing units, 100,000 workspaces, and a new university for more than 20,000 students, as well as new parks and retail and cultural facilities. With the financial surplus from its operations, the UWF has been able to help fund part of the extension of the local metro system as well as other infrastructure investments required by the developments and the city.

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In South Korea, around half of all residential land development and almost all industrial land development is carried out by the Korean Land

Corporation (KLC), which can be viewed as a national scale UWF. Since its formation in 1975, the KLC has played a key role in transforming the economy of South Korea by efficiently managing land and promoting economic development. The KLC's functions include developing and selling land for residential use, acquiring idle and vacant land for resale, and developing new towns.[9] This has helped ensure that land and housing has remained affordable. The ratio of house prices to income declined from a base of 100 in 1995 to 62.3 at the end of 2013, while the UK's shot up from 100 to 167.[10]

Urban Wealth Funds should have a mandate to maximise the value of their portfolio in order to be able to crowd in private investors. But through transparent owner directives local government can also ask that Urban Wealth Funds further social aims or missions such as housing affordability and the creation of socioeconomically mixed communities. Pension funds, for example, requiring long-term, reliable returns, would probably be good investors in mixed-neighbourhood social housing. Munich's housing and commercial property fund[11] works with the city planning unit to ensure that renewal and new developments blend housing for different income groups to avoid segregation. It also targets rent subsidies to low-income earners, gradually withdrawing the subisidy as their income increases.

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Despite its predilection towards privatisation, the UK does in fact have some examples of urban wealth fund-type models. London Continental Railways (LCR) has learned from Hong Kong's MTR 'rail-plus-property-model' and successfully developed areas around stations in some of the UK's larger cities. These include King's Cross station, once a run-down part of central London but now a highly desirable area, and the International Quarter of the Olympic Village at Stratford, east London, for the 2012 Olympic Games. LCR is focusing on property development and

9 Kaganova O (2011) *International Experiences on Government Land Development Companies: What Can Be Learned?* Urban Institute Centre on International Development and Governance. http://www.urban.org/url.cfm?renderforprint=1&ID=412299&buildstatic=1

10 Muellbauer J (2014) 'Six fiscal reforms for the UK's "lost generation"'. VOX CEPR's Policy Portal. http://www.voxeu.org/article/six-fiscal-reforms-uk-s-lost-generation

11 Münchner Gesellschaft für Stadterneuerung Gmbh is owned by the municipal housing agency which also owns an agency for development of commercial property.

land regeneration in several UK cities, often in connection with railway stations, such as in London, Birmingham and Manchester.

The government-owned Crown Estates also largely resembles a real estate-oriented wealth fund and, being worth £14 billion, is one of the largest property managers in the UK. It is an independent commercial business, created by an act of parliament, with a diverse portfolio of UK buildings, shoreline, seabed, forestry, and agricultural and common land. It has been particularly successful in turning low-yielding land into better-yielding wind farms, as well as managing its central London portfolio of assets. Over the past 10 years the business has contributed £2.6 billion to HM Treasury.

Another advantage of the UWF model is that it can offer relevant and adjacent private sector owners the opportunity to participate in development projects, as already achieved by LCR at King's Cross for instance. It can help facilitate planning and help to resolve conflicts among landowners for a particular project that is to be developed. For example, the UWF could offer land 'swaps' to owners who need to be persuaded to give up their land to support larger-scale developments. This ability only comes with scale and is more challenging for indvidual local councils. A UWF could also potentially play a role in supporting commercial property in distress, for example by offering to buy up property at a reduced rate when there is a potential for future redevelopment.

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Some councils may be wary of giving up their commercial assets to a relatively independent body. However, the local government would maintain the strategic control of the portfolio, to ensure the economic benefits follow long investment cycles beyond individual election periods. Consolidating all commercial assets under an independent single entity could allow for the production of an integrated business plan for the assets as a whole and the introduction of greater financial transparency and auditing of public assets. Other public jurisdictions, even state authorities, could also be encouraged to pool real estate within Urban Wealth Funds, at least when opportunities arise for urban renewal and housing projects along with adjacent private sector owners. This is often the case with developments of railway stations or waterfront developments, as seen in Hamburg and Copenhagen.

Over the coming decades, technological innovation and the net-zero carbon transition may well open new opportunities for multiple uses of public assets. Car parking space in valuable city centre areas could be freed up via the use of self-driving cars or improved public transport options. Ports and airports may see radical overhauls in their useage. Towns and cities that have a strong understanding of their real estate assets and their potential – and vehicles to exploit these to create public value – could be well placed to 'level up', whatever central government is or is not doing.

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