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FOREWORD

This book presents the main messages of an OECD LEED Programme, Forum of Cities and Regions conference that took place in London in July 2002 in collaboration with the London Development Agency, Greater London Enterprise and the City of London Corporation (the municipality for the "Square Mile" in London's financial centre). The theme of the conference was how to leverage private finance for local economic development activities in OECD cities and regions. The conference included practitioner presentations of approaches to financial leverage in various cities and regions in North America and Europe in the fields of brownfield regeneration, community development and small firm support, which are all summarised in this book. In addition, a number of papers were commissioned to provide further practical examples and recommendations for policy development, including discussion of the potential transferability of programmes from one city or region to another, given differences in the economic development instruments and powers available. These papers are all included in this book.

The book has been prepared and edited by Jonathan Potter from the OECD LEED Programme. Greg Clark, Kirstie Bennett, Mark Stevens and Meg Kaufman from the London Development Agency assisted in this work and the preparation of the conference, together with David Walburn of Greater London Enterprise.

PREFACE

by
Dame Judith Mayhew

Deputy Chairman, Policy and Resources Committee, Corporation of London
Chairman, London Development Agency Business Committee
Chairman, London Private Finance Commission

I am delighted to welcome the publication of this book on private finance for city and regional economic development. I would like to thank the OECD for the enthusiastic partnership that they have shown in working with us here in London. Dr Sergio Arzeni, Dr Jon Potter, and the OECD LEED Programme Team deserve our sincere thanks.

The Corporation of London, Greater London Enterprise and the London Development Agency have been working together on the theme of leveraging private finance for several years now. This is especially important in London. We have the biggest international financial services cluster in the world, and yet very few statutory economic development finance instruments into which institutions might invest. We have only very limited tax raising and borrowing powers at the local level.

We do not enjoy the same investment tools as New York, Tokyo, Paris and Shanghai, although we look to these cities and others for challenge and for collaboration. London has extensive investment needs if it is to remain productive and to tackle economic change and transition effectively.

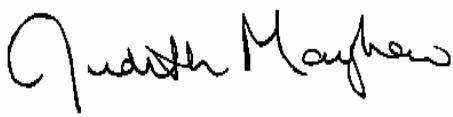
We need to build affordable business units for our high-tech start up companies, we need to get growth capital to our promising smaller firms, find ways to invest in our older town centres and industrial estates, and ensure that our poor neighbourhoods do not get left behind in terms of infrastructure and amenity.

As the UK's capital city, we are providing significant net resources to the national exchequer as a whole, supporting much needed public services and

infrastructures across the whole country. London will continue to do this, but we must also have the means to increase investment in London itself. A key means for achieving this is to use our public funds in ways which will attract and leverage private investment. This requires a different mindset in the public sector. Our task is to stimulate the investment opportunities for private partners and to make them consistently attractive so that a genuine market can grow.

This book, combining the report from an important OECD conference that we held here in London on this subject, along with detailed papers on various experiences from around the world in leveraging private finance for local development, provides perhaps the first international assessment of what is working and what more needs to be learned. I am delighted that London has worked with the OECD to help make this publication happen.

We have established a London Private Investment Commission in which almost fifty different representatives from banks, pension funds, insurance companies, accountants and other financial institutions come together to advise us on how we can better work with them to finance our key priorities. We are making steady progress and I want to take this opportunity to express my appreciation to those dedicated financiers who are working with us so enthusiastically.



Dame Judith Mayhew

Deputy Chairman, Policy and
Resources Committee, Corporation of London
Chairman, London Development Agency Business Committee
Chairman, London Private Finance Commission

London, May 2003

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CHAPTER 1
INTRODUCTION

by
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OECD LEED Programme

This book presents the findings of a Forum of Cities and Regions conference that took place in London in July 2002 in collaboration with the London Development Agency, Greater London Enterprise and the City of London Corporation and subsequent follow-up work. The book explores how various cities and regions in OECD countries are using the instruments they have available to draw private money into economic development, and tackles the difficult issue of what might be transferred between them in terms of best practices. By identifying, comparing and assessing some of the emerging tools and instruments in OECD countries, this book aims to provide advice and inspiration to cities and regions seeking to leverage private finance in their own economic development efforts.

Objectives

In the year 2000, the first conference of the OECD Forum of Cities and Regions, in Glasgow, Scotland, focused on how globalisation increases economic restructuring and competition at sub-national level, requiring city and region governments and development agencies to reinforce their policies for economic competitiveness and social cohesion (OECD, 2001a). Yet at the same time, public spending budgets are being squeezed and policymakers everywhere face increasing difficulties in financing the necessary projects purely from the public purse. This is why one of the first follow-up conferences of the Forum of Cities and Regions focused on the issue of how to maximise private sector financial leverage for economic development. This book presents the main results of the conference, exploring how various cities and regions in OECD countries are using the instruments they have available to draw private money into economic development, and tackling the difficult issue of what might be transferred between them in terms of best practices. By identifying, comparing and assessing some of the emerging tools and instruments in OECD countries, this book aims to provide advice and inspiration to cities and regions seeking to leverage private finance in their own economic development efforts.

In the past, the public sector has often tended to "go it alone" in seeking to regenerate derelict brownfield sites, assist excluded communities and fill SME funding gaps. Indeed, this has been seen as the classic role of local and regional government, namely to intervene when necessary to fix market failures in order that private investment may follow. However, many examples show that there is potential to involve private developers at an earlier stage and to a greater extent in projects that promise both social and commercial gains. By involving the private sector, local and regional governments can not only bring in new finance, but also increase project development expertise and help secure the sustainability of projects. To achieve it they need to break down barriers such as lack of information on development prospects and poor communications between the public and private sectors, as well as to find ways of reducing private sector risks to commercially acceptable levels.

This book presents examples of methods used by city and region governments and development agencies to leverage private finance into their economic development efforts, particularly in North America and Europe, and discusses the potential for transfer. The book shows that there are many tools and approaches available to the interested and innovative policy maker. These include targeted tax incentives, municipal bond issues, public sector guarantees or reserve matching for private investment, removal of new investment from the liability chain for environmental contamination, easing of planning restrictions

in brownfield areas, working with intermediaries to lower risk and pool resources, creating information on market viability and simply motivating investors to become involved.

The Forum of Cities and Regions of the OECD LEED Programme came together with the London Development Agency (the economic development agency for Greater London responsible to the Mayor of London), Greater London Enterprise (an economic development services company owned by London's 33 municipal boroughs) and the City of London Corporation (the municipality for "Square Mile" financial centre) to prepare this conference and book, because these are important issues for London in particular but also for all other cities and regions in OECD countries.

Why has leveraging private finance become a critical issue for OECD cities and regions?

The momentum for more active public-private partnerships in local economic development reflects a number of pressures affecting both public and private sectors. We can identify at least six key pressures leading to public-private partnerships that are present in virtually all OECD cities and regions, which explain why leveraging private finance has moved up the economic development agenda at this time and suggest lessons for the process of developing partnerships. We can look at these pressures from two viewpoints, that of the public sector and that of the private sector.

Pressures on the public sector

1. *The tax base*. Central governments are under strong pressure to constrain the increase of public spending to prevent passing on tax increases to their electorates and to protect their macro economies from the consequences of public deficits and borrowing. Cities and regions are faced with the same problem. Whilst they have often gained powers from central government for the promotion of economic development in recent years, they have not always been compensated for this by appropriate grants and transfers, leading to what are known as "unfunded mandates", and they have little scope to increase their own local taxes and borrowing (OECD, 2001a, 2001b). Whilst decentralisation may be welcomed as a way of improving policy effectiveness and governance, at the same time it increases the financial burden on local and regional authorities. In many large cities, there are additional problems of indebtedness, erosion of the tax base through out-migration to suburban areas and growing socio-economic distress in

certain geographical areas. So, from a simply financial point of view there is a need for city and region governments to tap into non-governmental sources of finance, in particular by leveraging private finance.

2. *Expertise.* As well as seeking new sources of finance, local authorities are also under pressure to increase the efficiency and effectiveness of the spending they make. Leveraging private finance can also help them in this respect. Public-private partnerships are often partly driven by a more proactive approach towards tapping into the expertise of the private sector. For example, the private sector may help the public sector to identify gaps in enterprise support services or specific training needs so that policies are well tailored to client needs. It is sometimes argued that when the public sector acts alone, for example to provide business incubation services for small firms, it does it less well than if it acted in partnership with the private sector or others. The local partnership model is now very widespread in OECD countries, partly with the aim of tapping into local expertise, as outlined in the OECD book Local Partnerships for Better Governance (OECD, 2001c).

3. *Recognition of barriers to investment.* City and region authorities also recognise that there is potential for a greater private sector contribution to many local development activities if the public sector intervenes to tackle well-targeted investment barriers or market failures. For example, barriers that constrain private sector investment in brownfield regeneration include negative externalities resulting from dereliction, information deficiencies and asymmetric risk relating to site conditions, ownership barriers, economies of scale and indivisibilities in land and infrastructure renewal and planning controls or other bureaucratic inflexibilities. Similarly, if we consider why the private sector is not more involved in small business loans or projects in deprived communities, we can identify both lack of experience and discrimination as key barriers. If city and region governments concentrate on overcoming these barriers then the private sector is likely to be "tempted-in" to exploit profitable niches. If the risks compared to the expected returns for the private sector are still too high, there are instruments available that allow the public sector to share some of the risk without being the only driver of development.

Pressures on the private sector

1. *Importance of local environment to economic development*. Michael Porter and others have popularised the notion of the "global-local" paradox. This refers to the idea that whilst globalisation levels out access to basic markets,

resources and technologies, and thus in theory companies can locate anywhere, the performance of companies is actually increasingly linked to the quality of the local environment where they are located (Porter, 1998). This can be thought of in terms of the supply of skilled labour, the transport and communications infrastructure, the quality of supplier companies and the presence of networks of knowledge flows among companies and institutions in related industries. All of these less tangible resources tend to be locally-based. Thus companies are increasingly recognising that they are embedded in geographical space and that their performance depends in part on that of the city or region where they are located. Companies therefore see a certain self-interest in participating in the improvement of aspects of the local economic environment that they depend on.

2. *Corporate social responsibility*. The notion of Corporate Social Responsibility is also increasingly discussed (OECD, 2001d). It involves companies undertaking voluntary activities with social objectives that go beyond their legal obligations, for example by investing pension funds in regional development projects, hiring and training disadvantaged youth or enabling employees to undertake volunteer projects in deprived communities. In the United States, major companies often invest in community development banks, supported by federal and state-level legislation. Thus we have a situation where for social reasons company stakeholders, in terms of employees, shareholders or managers, are driving efforts to get involved in improving the local communities in which they are based.

3. *New markets*. Finally, and perhaps most importantly, the private sector is also beginning to recognise that there are profitable markets in economic development activities previously undertaken by the public sector alone or with non-profit sector partners. For example, in the United States, many private companies are becoming involved in small business loan activities through community banks because they see that even the most distressed areas have market potential. Similarly, private investment in local retailing schemes, such as through Business Improvement Districts, reflects the fact that there is an important local market demand that has not been properly addressed. Furthermore, inner cities are important sources of available labour in metropolitan economies that often experience wage inflation because of general labour shortages and so more companies are considering them as areas for business location. Thus, a further reason for private sector involvement in local economic development activities is to tap into new market opportunities, often in currently under-performing areas with growth potential.

Why has London taken a lead by organising this conference and book with OECD?

During the last four years or so, London has undertaken research work on the role of private finance in local development in London and how to develop it. Much of this work is summarised in a foundation report called "London's Leverage" (London Development Partnership, 2000). London, through its municipalities, Greater London Enterprise, the London Development Agency and many other partners, is now at the stage of building a concrete programme of activities to follow up on the "London's Leverage" recommendations. The OECD conference and this book are intended to help London to refine and implement these recommendations in light of information on good practices and transferability from other OECD cities and regions facing similar challenges.

The "London's Leverage" report addressed some fundamental questions:

- What is the role of the public sector versus the private sector in terms of financing local development?
- Which aspects of local development are already able to sustain commercial returns?
- Which aspects of local development could sustain commercial returns if public sector intervention were designed in such a way that it was more enabling for private investing?
- How can leverage be optimised?
- How should costs, risks, benefits and returns be shared?
- How can new markets and new opportunities be promoted as part of the local redevelopment process?

Some key proposals from the "London's Leverage" report can be briefly summarised as follows:

- Set up a Regional Venture Capital Fund for London and a new set of better co-ordinated small firm loan funds.
- Create new financial intermediaries for community development and social enterprise.

- Create new financial mechanisms for town centres and small firm accommodation.

- Develop a planning regime and spatial development strategy that are better focused upon supporting private sector co-investment in London's economic development and regeneration priorities.

- Increase the degree of "London flexibility" in national co-investment programmes.

- Develop a set of detailed proposals for new partnership investment mechanisms.

- Develop an improved and more coherent "London take" on existing programmes (i.e. increase the "bending" of other public funds to London's development priorities).

- Establish a mechanism within the agency for finding the best way to finance high priority initiatives in London.

Each of these objectives is described in more detail in London Development Partnership (2000). In the longer term one further goal could be to increase flexibility in the use of certain public funds to create a better toolbox for private sector co-investment possibly leading eventually to a single co-investment budget along the lines of a "London Block Grant". A second further long-term goal could be to create a wide range of new specialist funds, fund managers and financial intermediaries, possibly leading to the creation of a "London Investment Bank" in partnership with national government.

Thus for London, as with other OECD cities and regions, leveraging private finance is seen as critical for the success of a whole range of local development activities, including investment in small and growing businesses, investment in social enterprises and community economic development, investment in town centres, investment in industrial estates and small firm accommodation and investment in regeneration partnerships.

However, London also has two particular concerns or contexts with respect to leveraging private finance, which help to explain why it is pioneering work in this area.

Firstly, London investment potential from its own resources is strongly constrained by the United Kingdom's highly centralised public finance system. Unlike many other major OECD cities, London's Regional Development

Agency and its 33 municipal boroughs have relatively little fiscal or financial autonomy and relatively few of their own public investment vehicles (Clark, 2001). In the main, London depends on government transfers and programmes for the bulk of its economic development efforts, and whilst this contributes to the expertise that can be brought to bear, it also limits the flexibility of city agencies to develop local solutions to local needs and to achieve the levels of spending required. It has often been argued that the overall level of spending on economic development in London runs far short of that required to provide an efficient infrastructure and socially equitable development. Firstly, London needs to provide services for entrepreneurship, housing, transport infrastructure and so on. Secondly, London needs to act to redress a strong polarisation between the relatively prosperous west of London and the relatively poor eastern districts, and tackle problems of poverty and underdevelopment throughout the city. This is a powerful argument for attempting to leverage private finance in order to make most effective use of what public economic development tools and finance are available.

Secondly, London hosts Europe's largest financial centre. Within this financial hub there are many banks and financial services institutions providing innovative products to their clients. Naturally, this has led many Londoners to question how they might tap into this source of finance and ideas for economic development projects in the backyard of these same organisations. With the above mentioned trends towards corporate social responsibility and the self-interest of finance companies to ensure a satisfactory local environment and access new markets the issue is raised of how these financial institutions might be more strongly implicated in London's economic development efforts. The aim is not an operation that seeks to tap into the charity of London companies, but rather for the public sector to demonstrate that there are ways of creating market returns to private investment in economic development with the use of appropriate tools. It is these tools that we explore in this book.

London will build on the analysis and recommendations of the "London's Leverage" report and this "Leveraging Private Finance" report by putting in place appropriate programmes to involve the private sector in economic development projects. This process has already started with the creation of the London Private Investment Commission (PIC). The PIC is a partnership of 50 financial institutions, insurance companies, pension funds, retail and wholesale banks and the Bank of England, who work together with local development agencies to look at options for structuring private investments in economic development. This is a useful forum for the London Development Agency, the municipalities and other local development agencies because it allows them to involve private institutions in the design of interventions before those interventions are put into place. The PIC can therefore make

recommendations on the feasibility of approaches proposed as well as offer ideas on a range of possible new initiatives, in which some of the members may even participate directly.

Although it is still early in the implementation process, new ideas are already being taken up by London Development Agency and its partners. For example:

- Rather than trying to participate in small business growth finance as direct grant aid or as a capitalisation of an existing fund, the PIC has asked that public support be more focused on the capitalisation of deposited guarantee schemes. This frees up members to undertake a wider range of deals and limits public aid to covering year-end downside losses spread across the whole of the schemes' portfolios rather than on each individual deal.

- A new Community Development Financial Institution (CDFI) is being developed with six commercial banks that are members of the PIC. The CDFI will act as a wholesale finance provider for a wide range of local initiatives.

- A regeneration investment fund is being created together with the European Investment Bank and pension funds. This regeneration investment fund will act as a long-term provider of structured inexpensive debt, serviced by the returns on deals.

- London Development Agency has also introduced, at a very practical level, a new performance target, such that every year the amount of private finance leveraged into disadvantaged neighbourhoods in London is measured as a key performance indicator of the agency.

Tools and examples examined

This book will present information on a wide range of policy instruments and practical examples that were debated in the conference and have been expanded upon in the papers especially commissioned for the book. The instruments and examples are drawn from many cities and regions with strong coverage from North America and Europe. The key focus is on three main fields of policy intervention, namely community building, support for small and medium sized enterprises and regeneration of brownfields.

There is discussion, for example, of how private investment in community development can be encouraged through regulation of the financial services sector, provision of trigger funding for pension fund investments, creation of secondary markets and the use of bond financing and tax increment financing. Examples, mainly drawn from the United States, include the Community Reinvestment Act, which encourages investment in distressed areas, the California Community Mortgage Fund, a commingled investment pool, the Community Reinvestment Fund, a secondary market, and the NoMA project in Washington DC, which helped develop a distressed community around construction of a new metro rail station.

In terms of SME support, the book examines tools for bringing private finance into public schemes for providing working capital and growth capital to needy companies, for example through public guarantee or mutual guarantee schemes, demonstration of viable markets through practical projects and measurement tools and use of intermediaries to support public-private partnership formation. Examples include microfinance activities of the Shorebank Corporation, a CDFI in the United States, partnership agreements in the Accord Programme of the North Milan Development Agency in Italy, the small firm accommodation and finance activities of Greater London Enterprise in the United Kingdom and SOWALFIN, a one-stop-shop financial vehicle in Wallonia, Belgium.

The book also examines mechanisms for the regeneration of brownfield sites. Instruments discussed include tax incentives and tax increment financing, revolving loan funds, voluntary clean up programmes, pilot projects, partnership structures, relaxation of planning restrictions, public bond issues for investment and offsetting liability for environmental degradation by prior site users. Case study examples include New York State, Chicago, Maryland and Illinois in the United States, and Glasgow (Scotland), Maastricht (Netherlands), Duisburg (Germany) and Lorraine (France) in Europe.

Recommendations are made from all these discussions on how to make such instruments work successfully and for which conditions they are best suited.

All these instruments and examples demonstrate that there are many opportunities for the public sector to leverage-in private investment if public agencies use their available finance, instruments and professional experience to create the right conditions for such investment. It is particularly important to build long-term structures that will sustain private sector interest over time, rather than attempt to interest the private sector in a series of individual one-off transactions. One of the lessons of the book is that the private sector responds

best to a stable and growing market in which clear templates for investment are available so that costs are reduced per transaction made.

Nevertheless one of the challenges that must be addressed in considering the practices presented in the book is whether an instrument or approach that works in one country or context could work in another. And this is why, in addition to discussion of contexts and transferability throughout the text, there are also two chapters focused specifically on this issue of transferability. Too often mistakes have been made in the past by seeking to import an approach without consideration of whether the factors that made it a success exist or could be created in the area seeking to adopt the approach. The key challenge for city and region policy makers is to explore why certain tools work well in certain situations and from that gain inspiration on what could be achieved in their own city or region given its unique circumstances.

Structure of the report

Following this introduction, the book is structured as follows.

- Chapter 2: Summary of conference proceedings, by Andrea Westall, New Economics Foundation, London, United Kingdom.

- Chapter 3: Community development, by Marc Weiss, Prague Institute for Global Urban Development, Prague, Czech Republic and Washington DC, United States.

- Chapter 4: Small- and medium-sized enterprises, by Rudy Aernoudt, Deputy Head of Cabinet to the Vice-President of the Walloon region and Minister of Economic Affairs, Belgium.

- Chapter 5: Small- and medium-sized enterprises: Constraints and possibilities in London, by David Walburn, Policy Adviser, Greater London Enterprise, United Kingdom.

- Chapter 6: Brownfield redevelopment: Strategies and approaches in Europe and the United States, by Stephan Tomerius, Deutches Institut fur Urbanistik, Berlin, and Uwe Ferber, Projektgruppe Stadt und Entwicklung, Leipzig, Germany.

- Chapter 7: City building in North America and Europe, by James Small and Glenn Miller, Canadian Urban Institute, Toronto, Canada.

- Chapter 8: Transatlantic comparisons, by Greg Clark, London Development Agency, United Kingdom.

- Chapter 9: Conclusion.

- Appendix: Conference programme.

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CHAPTER 2
SUMMARY OF THE CONFERENCE PROCEEDINGS

by
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This chapter summarises the proceedings of the London conference which laid the ground for the subsequent expert chapters in this book. The conference used case studies from Europe and North America to present the levers available to attract private finance into community building, SME development and the renewal of brownfield sites. It also examined the challenges of making them work.

Introduction

The public sector alone cannot address the multi-dimensional needs of local development. It is also necessary to engage local communities, and the private and not-for-profit sectors, in designing and implementing sustainable solutions. Additionally, public money is limited. Further finance needs to be harnessed to support the range of activities, which create and underpin sustainable wealth and job creation.

This chapter summarises the proceedings of a conference held on the 10th July 2002 which aimed to bring together a panel of international experts and practitioners to tackle one part of these challenges: how to leverage private finance to support local development. The event was organised by the OECD LEED Programme, the London Development Agency, Greater London Enterprise and the City of London Corporation.

By "leverage", we mean the variety of tools and methods available to the public sector that can attract private finance or business activity into localities and into markets that they would otherwise not consider but which are vital for underpinning local development. This generally means enabling the private sector to recognise and take up opportunities that have an appropriate and attractive risk/return ratio.

Private sector investment does not take place in certain areas or for certain groups of people due to a range of market failures or other barriers to investment. An example would be misinformation or lack of information about the level of market opportunities. Additionally, the market will not naturally channel investment to activities, which, although they may be critical for underpinning the creation of sustainable growth and jobs, do not provide adequate levels of return.

The case studies illustrate a range of ways in which the public sector can attract private sector investment through instruments, or packages of instruments, which create market, or near market rates of return for investors. The examples presented in the conference focus on successful initiatives in three specific areas: community building; small and medium-sized enterprise (SME) development; and the renewal of brownfield sites. The mechanisms discussed range from the simple provision of information to brokering partnerships, guaranteeing funds, providing targeted tax incentives, and to joint public-private sector commitments for investment.

These tools and techniques may include initiatives undertaken at a national, regional, local, or even international level. The national and regional levels are more likely to be appropriate for creating supportive fiscal or legislative frameworks. Whilst many of these tools create incentives for participation, some, such as the Community Reinvestment Act (CRA) in the United States, set a framework for action and in fact strongly encourage (with penalties for clear non-compliance) the private sector to become involved in certain markets. At the local level, it is possible to create targeted solutions that can work with the specific nature of problems, issues and capacity, for example, through providing information, co-ordinating partnerships or providing direct financial support. Whilst some case studies focus on direct relations between the public and private sectors, others involve working through specific intermediaries (often not-for-profit) which can harness resources and target investment on particular needs.

Section 2 below sets out the reasons why leveraging private sector investment is important for local development. Section 3 explores case studies of specific approaches and initiatives whilst Section 4 brings together lessons learned from the case studies and the experiences of conference delegates. An outline of the conference proceedings is attached as Appendix 1.

The importance and role of leveraging private sector investment for local development

Several speakers during the conference noted the historical reliance of local development on public sector money and interventions. However, with continued and increasing pressure to control the level of taxes and spending at all levels of government, there may be fewer public resources available. Finding further sources of investment from outside the public sector is therefore necessary.

Additionally, in most OECD countries, the partnership approach to local development is now seen to be the most productive way forward. These partnerships need to include the public sector, the private sector, the not-for-profit sector and of course the communities or beneficiaries themselves. It is believed that, for example, the private sector can bring finance and business activity, as well as experience and skill sets that can help to increase the efficiency and effectiveness of initiatives.

Another key reason for wishing to harness private sector investment is that public sector solutions are often dependent on political motivation and short-term funding streams. Ellen Lederman from Shorebank succinctly set out the

desirable alternative, noting that whilst public-private co-investments can be more time consuming or have higher transaction costs, the net effect is to create more robust projects, which have longer term success and sustainability and which fit with the needs of specific communities.

The benefits of harnessing private sector finance are great and go even further than increasing the amount of investment in development activities. Private sector activity also supports local development by, for example:

- Reconnecting local areas and people with mainstream markets and therefore creating new business and employment opportunities.

- Developing the physical infrastructure of local areas to increase their ability to attract further investment or be more attractive places to live and work.

- Providing goods and services that are currently under-provided by the market.

- Creating infrastructure and appropriate finance and support to develop new economic activity and support the growth of existing businesses.

- Supporting voluntary and broader not-for-profit activity through capacity building and financial investment.

The reason why the private sector would not naturally undertake investments in certain activities or areas is due to a variety of "market failures" or other barriers to investment which mean that opportunities important for local development are either not apparent or generate such low returns as to be unviable. These market failures can arise as a result of, for example:

- Lack of information or misinformation. For example, poor perceptions of an area or of particular entrepreneurs may mean that they are not considered as appropriate or marketable propositions. Alternatively, mainstream market analysis may be unable to identify viable opportunities in, for example, low-income areas. They use indicators relating to average income levels rather than total buying power and therefore underestimate market potential.

- Lack of experience. Many private sector organisations do not have experience of working in disadvantaged areas or with disadvantaged groups and therefore tend to avoid working with them, even if such activities could be profitable.

- Externalities. Where private sector activities yield positive social benefits that cannot be captured by the enterprise undertaking the activity there tends to be under-provision. For example, clearing dereliction and physical decay benefits the whole local area, but it can be difficult for one firm to appropriate the financial gains.

- Unviable markets. Some markets are not viable because the extent of the market is small or for some other reason it is impossible to create market returns. In such cases, ways may be found to effectively subsidise the private sector investor to achieve adequate returns. Alternatively, the private sector may, through partnerships, be able to create scale in transactions and deal flows.

There may also be a range of barriers to investment that may need to be removed, for example, planning constraints, or contaminated land.

If we want to support sustainable development, particularly for those areas with severe deprivation, we need to find ways to reverse a downward spiral of decay into an upward spiral of investment and growth. Part of the solutions for doing so involve finding mechanisms to address the above market failures and barriers to investment and to lower the risk for the private sector so that it can be attracted into markets that they otherwise would not serve.

The public sector's role then is to be the "catalyst" which can create the right "lever" or package of incentives in order to create a situation where the private sector will invest. In effect, the public sector is acting, in these situations, as a "market-maker".

There is a range of reasons why the private sector may wish to become involved in such initiatives. In addition to the obvious attraction of new business propositions:

- Companies also depend on their local economies and environment for many of their suppliers, customers, strategic alliances and skilled employees. They are therefore dependent on, and interested in, the development of their local or regional area.

- Increasing support for corporate social responsibility initiatives in local economies.

- The recognition that there are new markets and underused labour talent in distressed communities, which can be stimulated.

There is, however, no one private sector. While most companies will be keen to be involved only if there are full market returns, others may be willing to forgo some return in exchange for wider social and economic benefits. This may not be motivated entirely by philanthropy, since for example, investing in local infrastructure and development in the short run can lead to increased market opportunities and skill levels in the long run. Some private sector companies may be mission-oriented and seek directly to fill market gaps, as is the case with the Shorebank Corporation, based in the United States, which is discussed below. This example also illustrates the increasing overlap between enterprising not-for-profits and mission-driven private sector companies.

But the public and private sectors are often not the only players in these initiatives. Many of the examples used in the conference include the not-for-profit sector. Not-for-profits are often:

- Able to provide additional resources and hence make what was unprofitable profitable or viable.

- Have community knowledge and the ability to engage local people.

- Provide other services that can support market development, for example, training for SMEs, which can increase their viability and hence reduce their financial risk.

- Be the organisational structure for intermediaries which can create a legitimate way to pool and funnel private and public sector resources.

The case studies below explore the interrelationships between the different partner organisations and the nature of the leverage mechanisms for a range of development issues.

Case studies in community building, SME development and the renewal of brownfield sites

Community building

Community building can involve a whole range of activities from creating affordable housing provision, to providing skills and training for unemployed people, to creating new investment opportunities, improving health or providing access to goods and services that are underprovided, for example, small business finance or housing improvements. In many of these cases, private

investment may be attracted to some parts because they see market returns but not others. The role of the public sector then is to find ways to harness more private sector investment where appropriate but at the same time to ensure that local areas and people are not excluded from provision and from the benefits of the community-building activities.

The examples below illustrate a range of levers used to attract private finance into areas such as finance provision, housing development and the creation of a secondary market for development loans.

The levers include:

- Legislation encouraging the private sector to invest in certain areas or in certain kinds of people who would otherwise not be served and with penalties for failure to do so.

- Changing perceptions about the lack of investment opportunities in an area.

- Creating or working with intermediaries or consortia of private sector companies to lower risk and pool resources to create economies of scale.

- Creating partnerships with not-for-profits who can help create viable markets and lower risk by for example, engaging the community, supporting training of beneficiaries, or accessing other forms of funding.

- Tax credits focused on specific areas such as low-income housing.

- Direct financial subsidies.

- Motivating investors to get involved.

The Community Reinvestment Act and bank investment in underserved markets in the United States

For a variety of reasons, certain localities and individuals may be denied access to banking facilities and credit. Even if they are likely, for example, to create a good business or pay back their loan, they may find it difficult to access credit because they do not have a credit history, have no collateral or are located in an area with historically poor business success rates and low economic

activity. For these reasons, finance providers feel that these propositions are too risky and therefore do not lend.

Sandy Braunstein from the Federal Reserve Bank in the United States believed that the Community Reinvestment Act (CRA) in the United States has created a "critical turning point" in the level of private sector investment in underserved communities. The CRA, introduced in 1977, strongly encourages (and virtually requires) banks to meet the needs of all communities in which they operate, including low and moderate income neighbourhoods, as far as is consistent with safe and sound banking operations. This is achieved by periodic ratings of each major financial institution's lending record (CRA ratings), which the public can consult. Federal financial institution regulators consider that record in evaluating applications for charters or for approval of bank mergers, acquisitions, and branch openings. There is therefore a very strong incentive for banks to increase their performance with respect to underserved communities.

In effect, the US Government created a framework for shifting the burden of responsibility of investing in low and moderate-income communities from the public to the private sector. One effect of the CRA stimulus was that investors found that, when they did get involved in investments in under-served communities, it was often possible to find new viable markets and get good returns. The CRA has therefore acted as a driver for banks to consider how to create viable business opportunities rather than to just cross-subsidise delivery to certain market segments through necessity.

The banks often work with intermediaries in order to reduce risk as a result of the ability of community-oriented organisations to be able to understand and access local markets. Community Development Finance Institutions (CDFIs) for example, have been critical in enabling many banks to deliver against their CRA commitments, through flexible underwriting, cost mitigation, creating non-bank products, and reducing risks. CDFIs are locally-controlled financial intermediaries who primarily focus on serving borrowers and investors who are not able to readily access mainstream finance. They provide products and services that are either inappropriate or too costly for financial institutions. They may also support the capacity building of not-for-profits and hence create partners for new investment initiatives.

CDFIs in the United States can take several forms, including community development banks and community development credit unions, supplying under-served communities with traditional retail banking services like savings accounts and personal loans. Community development venture capital funds and micro-enterprise loan funds provide small business equity and loans, and community development loan funds support businesses, housing and

community facilities. These CDFIs work in partnership with conventional financial institutions to channel investment into distressed areas as well as drawing investment from other sources, including corporations, individuals, foundations and public money from the federal CDFI fund administered by the Department of the Treasury.

US banks have also found other innovative ways to create viable returns, for example:

- Banks working together to create loan pools or revolving loan funds in order to reduce cost and mitigate risk and to be able to participate in larger projects that might not be feasible on their own. The pooling, often through an intermediary, can cut costs through relaxed underwriting and can be used as subordinate financing alongside a more traditional bank loan.

- Loan consortia are agreements between organisations to create a common investment initiative, which is beyond the resources of any one member. This approach can mitigate risks and costs, and help support projects that do not meet bank under-writing criteria. A consortium may obtain not-for-profit status and therefore be eligible for government and foundation funds for supporting loans or operations that can create more viable investment opportunities.

- Partnerships between not-for-profits and financial institutions can create win-win situations for both sectors. For example, not-for-profits can access other forms of funding from, for example, government or foundations. They also know the community better and can support and encourage clients to use the services and hence enhance deal flow. They can also provide labour intensive services, for example, supporting the development of business plans by SMEs, which can reduce risk for the banks. In this way they can help to create marketable deals.

Sandy Braunstein also set out some barriers to investment by banks in underserved communities and challenges to the success of community finance initiatives. These include the need to:

- Develop and build capacity in the not-for-profit sector so that it can be an effective partner and also to create financial resources to support such organisations.

- Create equity products as well as debt.

- Develop secondary markets in community development in order to access capital markets. These allow investors in community projects to sell their loans, hence increasing the liquidity of their investments. In order to develop a successful secondary market for community development loans, issues such as non-conformity of products and perceived risk will have to be overcome. A secondary market exists in the United States in single-family home housing but not in other products.

- Undertake additional research and data in community development to see where money is going, how it is spent and its impact.

- Address the problems of economic downturns, which can make what was viable, unviable.

- Address the need for initiatives to be transparent and accountable.

Tax credits

An alternative approach to the CRA is to try to incentivise the private sector to invest in underserved markets through tax incentives. In the United Kingdom, the Community Investment Tax Credit has just been introduced which will provide tax credits to individuals or to institutions that invest in loan or equity funds earmarked for community development activities. These funds may provide finance to small businesses, social enterprises, or other community-based ventures including some property related development projects. Similar types of initiative may be introduced in other European countries.

Tax credits of this kind also require proactive support to encourage take-up by the private sector and to help create demand by capacity-building projects so that they are able to make use of the available finance.

In the United States, there is also a low-income housing tax credit which has been successful in creating attractive investments which otherwise would not be made. There is, however, concern that such fiscal-based incentives can be subject to change with the political regime or are susceptible to budget cuts.

Two community investment funds in the United States

Kirsten Moy from the Aspen Institute set out two examples of best practice in setting up community development funds, which harness and target private investment on underserved markets. One of these, the California Community Mortgage Fund, was set up to meet a finance gap for affordable housing and retail properties in inner city and low-income rural areas. The other, the Community Reinvestment Fund (CRF) was set up to fill a financing gap for a secondary market for small economic development and housing loans in underserved or economically distressed areas. Private investors are motivated to invest not just by market rate returns but also often because of commitment to the community development goals of the funds.

The market returns are created through a range of instruments including:

- A specific federal tax credit for low-income housing.
- A government programme to support rents for low-income people in qualifying projects with pension fund investment.
- Locally available grants and low-interest loans.
- Creating economies of scale through a non-profit intermediary.
- Use of grants from foundations and corporations to support the development of a Credit Reserve Fund.

Kirsten Moy listed the challenges from an investor's perspective for involvement in community development funds:

- The lack of familiarity of investors with low-income neighbourhoods, affordable housing, nonprofits and SMEs.
- The lack of historic performance data for similar investments.
- Preconceptions of risk and return based on mainstream assumptions. For example, mainstream investors may believe that an area with low incomes has no investment opportunities. Therefore there is a need for a more nuanced analysis to look at the relative buying power of an area and whether people can pay their debts.
- Low transaction size and complexity of projects particularly if they involve public-private partnerships with a multiplicity of players.

- Low volume and deal flow.

- Illiquidity of investments (in other words, the difficulty of selling before the end of the investment term).

- Unattractive risk-return that requires subsidies, credit support, tax credits or other investor incentives or project supports.

The ideal investment programme from an investor's point of view would be one that had:

- Seasoned and expert investment management.

- An appropriate risk-adjusted market in order to create a market or near-market rate of return.

- Pool or aggregate loans vehicle, which creates economies of scale and lowers transaction costs.

- A sufficient level of credit enhancement or credit support.

- Mechanisms for exit or at least a liquidity premium (an enhanced return to compensate for inability to exit).

- Insulation from political or public pressure.

- Clear articulation of the economic goal or impact with built-in monitoring and reporting to investors.

Both the examples below also illustrate several important points about leveraging private finance including the need for commitment, public or philanthropic support to set the initiatives up, and expert investment (possibly through a specially created entity). Both initiatives also required pre-investment for design and putting together the required instruments and resources. For example, it took $1.5 million to set up the mortgage fund and cover design, finding and developing management expertise, assembling the variety of financial subsidies and supports, and creating the infrastructure.

SME development

Small and medium sized enterprises (SMEs) are a critical part of sustainable local development – creating new employment and growth. They

can however suffer from a range of difficulties including access to finance, to appropriate and affordable advice and support or premises.

The case studies below illustrate: an organisation – Shorebank in the United States – which is committed to serving underserved SME markets; an agreement between the public and private sector in Italy – the Accord Program – to develop a disadvantaged area and to create appropriate infrastructure for SMEs; and lessons from Greater London Enterprise in creating SME finance support vehicles and suitable premises.

Levers to attract private finance in these situations include:

- The demonstration of viable markets through practical projects.
- Creating intermediaries to support partnership formation between the public and private sectors.
- Use of public money to develop areas to a point at which they become attractive for developers, for example, creating green space or transport links.
- Public sector guarantees or reserves matching funds to increase return on investment.
- Public sector subsidies to reduce capital costs.
- Bringing all relevant public sector agencies to address issues, particularly around planning and regulation.
- Creating information on market viability through new measurement tools.
- Public-private sector joint commitments.
- The encouragement of organisations such as Shorebank or CDFIs focused specifically on serving certain markets.

Box 2.1. **Best Practice Community Development Funds**

California Community Mortgage Fund is a commingled investment pool launched in 1994 to provide primarily long-term fixed-rate first mortgages for affordable multi-family rental projects and small retail, commercial and industrial properties in inner-city and low-income rural areas.

The Fund's investors include California Public Employees' Retirement System (Calpers) ($50 million) and Los Angeles Fire and Police Pension Fund ($25 million). These investors were motivated by concern over the high cost of housing in California and a lack of jobs and services in the inner city. They were attracted by an investment vehicle that offers professional management, geographic and asset diversification and market-rate returns.

The market-rate returns are supported through federal level Low Income Housing Tax Credits and a special US Department of Housing and Urban Development (HUD) programme for pension fund investors in affordable housing. This initiative allocates support for long-term rental assistance for up to 50% of the occupants on qualifying projects. At the state level there is an additional housing tax credit, and at the local level occasional grants and low-interest loans.

The minimum loan size is $1 million and the maximum – 10% of the fund. Loan terms are 10-15 years. The collateral is first mortgages including leasehold mortgages. The price of loans is risk-adjusted and based on the spread over comparable term US Treasury bonds. The rate depends on the type and risk of the project. An initial $75 million has been largely committed or disbursed and CalPers has committed another £100 million subject to matching requirements.

An example of a project is a 43-unit affordable housing initiative for service workers and their families in Sonoma County north of San Francisco and a 132-unit apartment complex for low-income elderly residents in Calexico near the Mexican border.

The *Community Reinvestment Fund* (CRF) is a secondary market for economic development and housing loans that are purchased from community lenders around the United States. The Fund is a Minnesota-based non-profit corporation set up in 1989 to provide new loan capital to community-based public sector and non-profit lenders to enable them to recycle funds and engage in further lending.

The CRF buys loans at their fair market value, which are discounted if their interest rates fall below that of the current market rate. There are certain specifications on the loans being bought, for example, that they have satisfactory loan documentation and are performing. CRF reviews each loan or pool of loans as well as the track record of the loan originator or servicer prior to purchase. Occasionally, the seller may be asked to provide additional collateral or credit enhancement or agree to repurchase a loan if it goes into default. The loan sellers have to reinvest the proceeds they receive in new community development loans. The price of the loans is risk-adjusted and based on the average life and risk of the pool of loans backing each debt security.

To finance the purchases, CRF has issued debt securities backed by the loans. The latest issue closed in June 2002 and totalled just over $10 million. The average weighted interest on all the notes issued was 5.9% which is about 200 basis points over the 3-year Treasury rate and the issue was oversubscribed by a ratio of 2 to 1.

CRF's **investors** include banks, insurance companies, pension funds, utilities, foundations and religious orders. Funds are also contributed by foundations, corporations and others to capitalise the Credit Reserve Fund. This Reserve Fund is used to acquire additional loans to provide a higher level of collateral for the bonds it issues and purchases, and to warehouse loans prior to their sale.

CRF has purchased more than 1 300 development loans totalling over $230 million from 92 organisations in 25 states and the District of Columbia and has currently $200 million assets under management. An example of a loan purchase was that of the Economic Development Authority of East Grand Forks in Minnesota which received $121 460 for three small business loans which enabled it to provide new working capital to a local manufacturer seeking to expand their customer base.

Shorebank Corporation

Shorebank is one of the oldest Community Development Finance Institutions (CDFI) in the United States. A CDFI is a private-sector (or not for profit) financial intermediary which focuses primarily on community development. Shorebank was set up 28 years ago in Chicago's South Shore neighbourhood through the take-over of a failing bank. It now operates in five cities in the United States with an impressive 13% return on investment.

They see themselves as a "mission-oriented" and "profit-oriented" but not "profit-maximising" company. Their aim is to be a development bank/holding company that is aimed at increasing opportunities in under-invested communities. Their financing supports housing, small business development, commercial real estate or providing financial services. They link unconventional borrowers to conventional finance markets through the provision of credit, technical assistance, savings and financial services.

Shorebank's philosophy is to use local knowledge and commercial approaches to rebuild communities. They don't just work alone and will work with private banks and develop local lending capacity. Seventy-three shareholders have invested $63 million in Shorebank including individuals, foundations, banks, religious groups, pension funds and government. These organisations are committed to the aims of Shorebank and help to balance the social and commercial objectives.

Their small business loan portfolio was $76 million in 2001. They addressed the needs of SMEs because of the potential market failures in finance provision arising from their higher transaction costs and low-level loan requirements. The types of businesses supported include franchises, service companies and not-for-profits, manufacturers, retail, contractors and hospitals (through leasing arrangements). They use character lending for clients with a credit problem (in other words lending on the basis of the ability of the person to run the business) and public sector guarantees. These approaches clearly pay. The profitability of their business loans is 2.65% pre-tax profit.

Shorebank uses a range of public sector levers to support its business banking portfolio. One example is the US Small Business Administration (SBA) 7A Program where the bank can obtain a guarantee of up to 80% of the loan. Shorebank is a "preferred" lender, which means that the bank can commit the SBA without prior approval. The SBA 504 Program is a capital asset financing programme that supports real estate investment and equipment financing. Shorebank finances 50% of project costs and is the lead investor. An equity investment stake of 10% is required and the remaining 40% is supported by SBA bonds which are below market, fixed rate with terms up to 25 years. There is also a State of Illinois Capital Access Program (CAP) which matches reserves up to 150% and can be used against losses.

Shorebank's demonstration of viable markets has led to other market entrants. Shorebank is the number one user of CAPs in Illinois but only the 5th largest user of SBA 7A which shows the extent to which the market has moved to using these kinds of instruments.

They have also created a partnership to attract investment, particularly underprovided services, into disadvantaged areas. The initiative – Metro Edge – aims to measure buying power, look at what purchases are made and how much money is leaking out of the area. Rather than focusing on standard measures such as median income, they look at the spending power of the more densely populated lower income areas.

By measuring buying power, consumer behaviour, and market trends using polls/surveys, listings or through buying networks, they can create business profiles of local markets. They have therefore created cutting edge modelling techniques for site location and market segmentation, which can support new private sector investment. Key sectors are retail, financial services, government and community sectors. One example was when Retail Chicago, a division of the City's Department of Planning and Development, proposed an inner-city site which was rejected by IKEA on traditional models of market size based on median income measures. Metro Edge provided a site analysis and a sales

forecast based on their specialised metrics and local data such that IKEA reconsidered.

This tool is one solution for a broader problem for disadvantaged neighbourhoods which have undervalued assets and under-utilised assets which are hard to find because of the lack of specialised market intelligence and poor economic and employment networks.

In general, Shorebank believes that their structure as a mission-oriented private institution enables them to focus on low-income customers but, because they generate surplus or profits, they are able to have:

- Superior staying power.
- Reach scale.
- Retain talent and build on early success.

Accord programme

The Accordo di programma (Accord Programme) is a Lombard Regional Law in Italy established since 1994 to support urban transformation in former industrial areas. It is, in effect, a set of joint commitments between the public and private sector to restore disused buildings, for example, and where the aim is for public funds to stimulate private benefits. The agreement lasts for three years and there is fast public decision-making so that the commercial sector can carry out their plans to a clear timetable.

Examples of its use are in North Milan through the North Milan Promotion and Sustainable Development Agency (ASNM), which is a public/private shareholder company with shareholders including municipalities, regional government, the Milan Chamber of Commerce, and property and finance companies. Set up in 1996, ASNM's aims are to support enterprise creation and bring sectors together to help regenerate the area.

The Accord Programme works through a preliminary agreement between partners. For example, in the Concordia Sud Area of North Milan the owners of the land, the Falck Group, had to sell land to the municipality or to ASNM at an agreed price to be used for new business development and then to sell land at market price to the private sector for the development of services. Other examples of commitments from the private sector under the Programme include demolishing buildings, restoring or constructing new buildings for certain types

of business, free transfer of certain areas of land for town planning, free transfer of a building to be reconverted into an incubator and the creation of green areas.

ASNM's obligations in the Concordia Sud agreement were to allocate at an agreed price, plots in the area by means of a public competition to SMEs. They also created promotional activities to support the investment of small businesses in these areas as well as providing support to the businesses.

More generally, the public sector uses public and European Union (EU) money to, for example, buy the land or stimulate building. Public funds have been used in the Programme to:

- Restore disused buildings.
- Support the creation of clusters of industrial, handicraft and service enterprises.
- Provide infrastructure for industrial areas.
- Reclaim land.
- Create green spaces and roads.
- Disseminate information on business development possibilities.

Lessons from Greater London Enterprise (GLE)

Greater London Enterprise a development agency whose very existence depends on its ability to leverage private sector finance through creating partnerships with the public, private and non-profit sectors They have set up a range of financing instruments to support small firms, from community development finance institutions (CDFIs) to equity products and business angel networks.

In London, David Walburn from GLE pointed to the short supply of good quality and affordable accommodation. This situation can mean that businesses are forced to move out of the city or it can result in constraints on business growth. Rental increases in London have arisen because of the competition of, for example, retail outlets with housing. Commercial funds have been inhibited from supporting workspace development due to the poor returns. However, there are examples of entrepreneurial niche firms supplying good quality SME accommodation. He argued that the experience of those successful firms shows

that “there is a need to understand the market well with its own planning and other regulatory regimes” and that partnerships between local authorities and the private sector can “bring substantial amounts of commercial funds into play”.

Public sector levers used here can include:

- Using subsidies to reduce capital costs and therefore lower rental levels.
- Engaging the planning and regulatory regime to make sites available and avoid the need for subsidy.
- Ensuring that all public sector agencies with an impact on site availability work together.
- The need for strong and committed political leadership.

David Walburn also spelt out some of the key success factors from their experience of developing CDFIs:

- Creating good quality deal flow – there has been a presumption that SMEs will just walk through the door but there is a need for sophisticated marketing to attract clients.
- Rejection of the common tendency to think that entrepreneurs in deprived areas are not entrepreneurial.
- Creating a public sector response, which is sophisticated, niche, targeted and informed, to attract commercial respect and trust.
- Working to a commercial sector timetable.

Brownfield development

Land development may be inhibited due to the high cost of dealing with such issues as contamination, planning restrictions, or risk of flooding. The case studies here of a Scottish Investment Park and the New York State Brownfields Program illustrate a range of public sector levers for attracting private sector investment to support this development including:

- Subsidy to clean up areas.
- Provision of information on potential market opportunities.
- Commitments from both sides in terms of actions to be taken and intended use of land in order to ensure that certain development objectives are met.
- Removing planning restrictions.
- Removing new private sector investment away from the chain of liability for environmental contamination.
- Use of bond issues to provide public sector investment.
- Special-purpose finance vehicles to lower risk for investors.

Cambuslang Investment Park

Colum Halforty from Scottish Enterprise Glasgow outlined an example of brownfield development in Scotland with innovative use of public sector levers. Scottish Enterprise Glasgow is part of Scottish Enterprise which is funded by the Scottish Parliament and European funding with the aim of promoting new and existing businesses and learning and skills.

Cambuslang Investment Park was created from a derelict brownfield site located on the outskirts of Glasgow. It was an area of 350 acres that used to be an ironworks and colliery. In the 1970s the buildings were demolished, some landscaping was undertaken by the public sector, and several plots were sold to property developers. But 250 acres remained vacant and derelict for the next 10 years.

Scottish Enterprise does not see property development as an end in itself but rather a tool to improve the economy of an area. This was particularly important in the area of Glasgow where the Investment Park is situated since it is an area of severe disadvantage. Additionally, inward investment was being attracted away from Glasgow by an enterprise zone outside the area.

Scottish Enterprise set up a strategic site team in 1995 and created a master plan to interest developers and to create an image change for the area. Above all they *told* people about the area. They designated one area as a food park, another for distribution and another for general industrial development.

Some of the land was contaminated and there were few available public funds. Rather than do the development work as and when they could, they decided to start with an area called the Junction and to build, for example, half a road and half the landscaping with the help of European funding. Initially there was no response but then one developer took a plot. They now have national businesses located there including John Menzies and Scottish Media Group.

The public cost was £5 million. That money was enough to prove the value of the site and enable them to sell the balance of the land at a value that reflected the work that needed doing. Fifty acres of land were brought back into economic use and, as a result, the private sector earned money and the public sector obtains new business premises.

In mid-1999, Scottish Enterprise wanted to get rid of another area in the park, The Gateway, which was subject to flooding. An engineer created a solution that would reduce the cost of flood prevention, remediation and the provision of infrastructure to £14 million. They designed a brochure for developers, advertised and held a conference for potential investors. They set twelve developers the task of creating a programme, leaving it to them to decide the best use for the land but committing them to building 6000 m^2 of speculative space within six months of completion. They also had to create infrastructure in return for which they were able to use the land for sale. The infrastructure is now nearing completion and already the chosen developer has built a building for a drinks distribution company with no support from the public sector.

Comparing costs for the two projects, Table 2.1 shows that the Junction has generated a leverage of 1:4 public to private sector investment to date and the Gateway project has a projected leverage of 1:6.

Scottish Enterprise sees the overall benefits of the Investment Park as being:

- Reinvigorating one of Glasgow's most deprived areas.
- Reclaiming and maximising the benefits of a brownfield site.
- Providing a competitive advantage to local commerce.
- Attracting new inward investment.
- Creating jobs in Glasgow and in the surrounding areas.

Colum Halforty concluded from this work that the private sector can be effective by establishing an economic development community to make a site "market attractive". You also have to understand what the private sector wants, be visionary, entrepreneurial, take risks and stick by decisions.

Table 2.1. **Comparison of the public-private sector leverage in two areas of Cambuslang Investment Park**

	The Junction	**Glasgow Gateway**
Area of site	50 acres	103 acres
Public Sector **Investment in infrastructure**	£5.1 million	£9.1 million
Private Sector **Investment in infrastructure**	£0	£4.9 million
Public Sector **Investment in buildings**	£163 000	£0
Private Sector **Investment in buildings**	£21 million (to date)	£46 million (anticipated)
Public:private leverage	1:4 (to date)	1:6 (anticipated)
Cost per acre to public sector	£105 260	£88 350

Brownfield development on New York's Waterfront

Randy Daniels, New York Secretary of State, pointed out that there are five million brownfield sites in the United States which need to be cleaned up and the challenge is that there is not enough public sector resource to enable this to happen. The private sector is often reluctant to become involved because it could become caught in a chain of liability for owning land that is contaminated or which requires significant clean-up. The only way to get private sector involvement is to remove new private sector contractors from the chain of liability and subsidise involvement in sub-market return developments.

In New York State there are 6 000 brownfield sites on 4 000 acres. 2 300 of these are on the shoreline. This means that much of the waterfront of New York looks bad and land values can be low, zero or even negative because of the legal liability for environmental problems and the high costs of clean-up. In addition, because of the growth of the suburbs there has been urban decline in

the central city area. The State government therefore wants to preserve open space, create new residential and business properties and clean up the Hudson River.

The original strategy focused on the principle that “the polluter pays” but this approach led to much litigation and bankruptcy. In 1979, New York State set up a fund to clean up highly contaminated sites, hold polluters responsible for cleanup and address sites where there was no private sector money available. But in the 1990s it was recognised that, whilst this approach was able to clear the most contaminated sites, liability issues were discouraging the cleanup and redevelopment of less contaminated sites. In order to clean up these areas, the State set up programmes to finance public spending as well as to create financial and legal incentives to encourage private sector investment, for example, by obtaining a release from liability.

The New York State Brownfields Program has two elements: firstly, where the owners clean up their own land, with public support graded according to their intended use of the land, and secondly, where the State bears all the cost for cleaning up the land. The State was also authorised $200 million under the Bond Act which allows them to pay 75% of the cost of the programme.

There are 104 state-supported projects. One example is Queens West Site where there is a plan for developing the brownfield area into residential properties. They plan three commercial buildings, a park and an esplanade. The total investment including the private sector is expected to be $2.3 billion.

The success of this project is due to the fact that the site was made development ready by the public sector. The private sector is often frustrated by having to get approvals to go ahead, for example, on cleaning up an area, on zones, on community participation. This can be a disincentive to investment so the public authorities also helped to overcome these barriers.

The government’s investment is likely to be repaid in the long run through increased tax revenue. The returns to the private sector are high since the land is free, the cost of money is reduced and risk is reduced.

Innovative financing models have also been important. For example, a new not-for-profit business group, Brownfield Capital, has created a special purpose vehicle that can shield investors from liability. They have a Brownfields Value Contract where you can aggregate deals and float the package. This has attracted particular attention from the New York City Partnership.

Overall, Randy Daniels concluded that there is a need to change the relevant legislation, provide fiscal incentives and state support, remove new investors from liability for clean-up, provide planning assistance, and create special purpose finance vehicles. He noted that projects can take a long time to become profitable and that there is also a problem if there is a downturn in the economy. In these situations the government may need to be patient and restructure agreements.

Lessons learned from the case studies and experiences of delegates

Ways of leveraging private investment

The case studies above show how a range of different public sector levers, or packages of levers and incentives, can be used in order to attract private finance to address specific local development issues.

It is important to note that attempting to lever in external finance may not always be appropriate or possible. The example of the New York waterfront above shows that in certain circumstances public sector money is required or alternatively support for not-for-profits, who may be directly concerned with addressing such issues. In these cases, there is no market return to be made (at least initially) by private sector investment.

The instruments used can be categorised by their intended effect:

- Reducing the risk for the private sector. This is about risk sharing between the public and private sectors and involves such instruments as public sector guarantees or matching fund reserves.

- Increasing the returns for the private sector. This may be done through, for example, direct subsidies or targeted tax incentives. Other techniques involve encouraging clever methods for creating economies of scale, for example, through loan consortia.

- Removing barriers. Barriers to private sector investment may be quite specific to the area or issue, for example, removing private sector companies from chains of environmental liability if they are not at fault.

- Changing perceptions and demonstrating markets. If lack of investment is due to misperceptions about particular areas or

particular groups of people then providing information which illustrates their market viability and finds "hidden markets" can be extremely effective in attracting private finance. A case study example is that of Metro Edge which used new measurement techniques to show market viability in certain disadvantaged areas. Piloting and showcasing organisations, such as Shorebank, that are able to create markets and market returns would also be another method.

- Requiring or forcing the private sector to engage in certain markets. This approach is exemplified by the Community Reinvestment Act in the United States for example. In this case there is little risk sharing but rather risk transfer to the private sector. Another method is that of creating joint public-private sector commitments, which provide both opportunities and responsibilities to the private sector, for example, requiring a statement of intended land use.

These interventions can be placed on a spectrum from the relatively inexpensive and hands-off role of the public sector in providing information or brokering appropriate partnerships to ongoing public sector funding and co-investment over time.

We can also look at these levers by form:

- Legislative instruments which allow, for example, targeted tax breaks or the ability for the public sector to raise finance, for example, through bond issues

- The public sector creating or supporting partnerships or specific institutions which help to create markets and channel private sector investment and public sector support for productive local investment.

- Removal of bureaucratic barriers.

- Simple grants and subsidies.

- Provision of information to the private sector or the creation of new tools to provide information on market opportunities.

In all these cases, the public sector may directly undertake these interventions or may support intermediary organisations or not-for-profits who may be best placed to do this work. Many entrepreneurial not-for-profits are extremely good at creating new markets through mixing public and private sector inputs and finding new ways to work with client groups. Intermediary

organisations may be able to pool the inputs of the private sector, attract additional resources, reduce risk and create scale from enabling a group of companies to act together.

Ensuring that investments actually make a difference to areas and people may require an element of targeting. Whilst this approach may smack somewhat of "state planning" and is not without risk, it may be necessary to ensure that the returns from an investment actually benefit the area rather than just flow straight out.[1] An example would be preparing land for development where certain areas are designated or retained for certain uses that are important to the local area.

It is also crucial to understand the nature of the private sector. The case studies clearly show the different motivations of different companies, ranging from those businesses that are only interested in creating new market opportunities to those that are keen to invest in areas of need at different market returns, from full market return to near or even low market returns. Some businesses such as Shorebank specifically focus on addressing market failure and supporting local economic development. These "mission-oriented" organisations are particularly effective at demonstrating market returns.

An important consideration is whether the "market-maker"' role of the public sector is temporary or permanent. In other words, is the nature of the market failure or barrier something that can be easily corrected or is it likely to require long-term public support or subsidy of some kind? An example of the former might be reducing the complexity of planning constraints or dealing with contaminated land. An example of the latter could be guaranteeing or subsidising a fund that supports not-for-profits in rural areas where there are very "thin" markets which may never generate full market returns but where the benefits to local communities are great.

The case studies also illustrate the ways in which different levers work at different spatial scales from the local to the regional, national and even international. The nature of the devolution of legislative powers, or budgetary freedoms will impact on the level at which different interventions can be made. A highly centralised government will create fewer opportunities for local freedoms and flexibilities.

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1 The problems of "gentrification" of an area are well known – where incentives to invest in an area result in the area becoming attractive to wealthy people who then push up the price of houses and rent and in effect create no discernable benefit to the people that live there and in extreme circumstances could force them out.

Critical success factors for public-private co-investment

Despite the different contexts of the individual case studies, and the different national fiscal and legislative frameworks in which the interventions are situated, the discussion between speakers and participants came to surprisingly common conclusions about the critical success factors for the public sector in designing the most appropriate public-private co-investment. In addition to the appropriate identification of instruments such as those set out above, the public sector should:

- Understand the market, the players and the intervention. There is a need to think creatively about how best to incentivise viable markets and to understand the strengths and weaknesses of different sectors, particularly the benefits but also the limitations of private sector involvement. It is important to appropriately communicate the market opportunities and the nature of the short or long-term potential returns. Also, different investors have different investment needs and appropriate mechanisms need to be designed in order to accommodate such diversity.

- Show political will, commitment and vision. Without clear commitment, vision and intention from the public sector, the private sector will not be convinced to engage in such initiatives.

- Create partnerships. Many delegates pointed to the need to involve the private sector right from the beginning rather than present them with a fait accompli which may inappropriately recognise and incorporate their needs and concerns. It is also important to recognise the importance of other players such as not-for-profits and to ensure that partnerships are set up where each partner does what they are best at.

- Ensuring pre-investment to get initiatives up and running. There is a need to allow sufficient up-front financial investment to kick-start initiatives.

- Show professionalism, risk-taking, entrepreneurship and work to commercial timetables. It is also important to find ways to cut down the lengthy processes and bureaucracy of funding applications which can hold up projects.

- Understand what cities, localities and regions own and what their assets are in order to sweat these and use them to catalyse private sector investment. Public authorities often have unused or underused

assets such as land and buildings which can be developed to provide catalysts for further private sector investment, through, for example, creating managed workspaces or new land for property development.

- Having a champion or strong leadership. Projects seem to benefit from a champion or lead body who is supported by both the public and private sectors.

- Joining up public sector provision and departments. Specific initiatives often require public sector inputs or depend on legislative frameworks or flexibilities which come from different public sector bodies and departments. In order to prevent a project from being blocked or reduced in its impact by specific public sector activities, there needs to be strong partnerships within the public sector to ensure that relevant interventions and public policy work in the same direction.

- The need to evaluate the efficiency and effectiveness of initiatives. Good impact measurement can not only assess the full outcomes of a package of interventions but also enable the consideration of the effectiveness of public sector leverage. Evaluation should not be limited to financial returns but also incorporate the wide range of social returns that are created. Appropriate measurement can also help to communicate the wider goals of the projects to private sector partners. Currently, good evaluation appears limited.

- Capacity building not-for-profits. Not-for-profits have been recognised as valuable partners and trusted intermediary bodies for co-investment initiatives. However, in order for their inputs to be effective, there is a need to ensure that they can build their capacity and adequately cover core costs. This may require relevant advice and support as well as accessible loan and funding facilities. It was also pointed out that the private sector can help to develop not-for-profits through, for example, secondments or providing support in marketing or finance.

- Co-ordination of local and regional initiatives. It was pointed out that there is a need for dialogue between cities and regions so that people know what others are doing in the field of private co-investment and in order to pool and co-ordinate resources in order to create more effective programmes. There was general agreement for the need to

create formal mechanisms for information sharing and exchange between cities and regions.

There are also several issues that still need to be recognised and/or resolved and which can therefore create problems for these kinds of interventions:

- Competition between private sector and intermediaries. For example in the United States some CDFIs set up by banks are so successful that banks have rethought their products. This can create a political situation of competition between the CDFI and the original bank that set it up. Some organisations have folded because private markets have taken over or they have moved on to create new products.

- The accountability of initiatives. The private sector does not wish to be caught up in political posturing or be put under the spotlight for their activities. On the other hand, use of public money, whether directly through subsidy or indirectly through tax incentives, requires accountability mechanisms and transparency to ensure effective and legitimate use of such funds.

- Economic downturn. Many initiatives may work well when economic conditions support the appropriate level of demand but economic downturns can create severe problems for market-based initiatives. The public sector needs to be prepared to restructure the deal in such circumstances rather than allow the initiatives just to fail.

How far is successful experience able to be transferred to other cities and regions

The case studies take place in a variety of economic and social circumstances as well as different legislative and fiscal arrangements. One of the most important differences between areas will be that of the relative local freedoms to raise finance and create risk-sharing vehicles for investment.

One particular example is that of bond finance. In the United States, it was noted that one of the drivers for local public-private investment was the ability to issue bonds. The United States has developed a framework for allowing local investment and finance raising whilst at the same time controlling the amount of overall spending. There is a volume cap where the federal government authorises a level of tax exempt financing for economic development for each state which is about $900 million per year. The state devolves the volume cap

portion through the municipalities to local economic agencies. In the United Kingdom, on the other hand, there are severe restrictions on local government spending and therefore little or no ability to issue bonds for local development.

One of the precursors for further developing public-private co-investment is to allow increased local finance raising flexibility and to recognise that this is investment spending. In other words, such initiatives will realise a return for the public sector in the future from returns from increased taxes.

The European Union also has strong State Aid legislation, which prohibits certain types of subsidy for private sector investment. For example, it is hard to effectively subsidise private sector developers to clean up say contaminated land. It was suggested that ways round this could be to transfer ownership temporarily or to tax the owners. More generally, EU State Aid legislation needs to be investigated in terms of its application to situations where government support encourages business activity that generates substantial positive impacts on highly disadvantaged areas or for socially excluded people.

There are also more subtle differences in political commitment to this kind of approach as well as areas where there has been a history of strong local cross-sectoral partnerships. The United States, for example, tends to have more of a history of private sector commitment to regeneration, for example, through the bank involvement with CDFIs and also through the Business Improvement Districts where companies voluntarily agree to an extra tax or contribution to finance local economic development. In Italy, a key success factor of the Accord Programme is that municipalities are co-operating more and mayors are becoming development leaders.

Conclusions

The conference succeeded in illustrating a wide range of potential levers for channelling private sector investment into areas and activities that will generate long-term local development benefits. In effect, these examples show the role of the public sector as being that of a “catalyst” or market maker rather than the direct provider of services. This change in function is a challenge to local government bodies since it requires risk sharing and an entrepreneurial and market-oriented approach. At the same time, this way of working also needs significant central government commitment and the creation of supportive national and regional frameworks. It also requires the ability of central government to allow the local and regional level greater financial and practical freedoms to incentivise such initiatives.

The key messages for the public sector are to:

- Clearly understand the nature of the barriers to investment by the private sector and explore appropriate instruments to leverage that finance.

- Recognise the differences between private sector motivations for involvement and design accordingly.

- Understand the importance of demonstrating and uncovering new market opportunities that otherwise might be "hidden".

- Show commitment and recognise the long-term nature of many of these initiatives.

- Don't go it alone but create strong partnerships of all appropriate players from the start.

- Be accountable and transparent.

And above all, be innovative. It may be easy to revert to public subsidy but there are many examples presented here of clever ways of harnessing investment through intermediaries or creating scale or local commitments which can both save public money and be more effective in creating long-term change and new business opportunities.

CHAPTER 3
COMMUNITY DEVELOPMENT

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This chapter addresses the specific issue of leveraging private financing for community development, primarily in economically disadvantaged urban neighbourhoods that are not generally thriving through the normal working of private market activity.

In the United States, financial leverage is a longstanding concept and practice. In business, it is often called OPM – "other peoples' money." The basic principle of securing ownership of valuable assets via borrowing is well established, whether through a high loan-to-value ratio first mortgage to purchase one's home, or through a leveraged buyout of a corporation. This same principle of leverage applies to attracting shareholders and other equity investors – from venture capitalists to limited partnerships – with an ever-expanding list of innovative financial instruments and intermediaries designed to increase the availability of both debt and equity capital. Public policymakers have generally focused on promoting their own form of leverage due to the longstanding preference in the United States for private market activity, and the fact that private resources are generally much larger than public budgets. In the case of distressed areas of cities and regions, however, one of the main reasons these communities are facing economic and social difficulties is that they have been experiencing a far greater degree of private disinvestment than of capital infusion. Indeed, the term "redlining" was coined to describe just such a withdrawal of capital, and the Community Reinvestment Act was established by the U.S. government in 1977 precisely to address this problem, both requiring and encouraging private lenders to provide more substantial financing for neighbourhood improvement.

In this chapter, I will address the specific issue of leveraging private financing for community development, primarily in economically disadvantaged urban neighbourhoods that are not generally thriving through the normal working of private market activity. These are communities that need some additional public assistance to promote new investment in business growth and job creation, affordable housing and homeownership, transportation and infrastructure, stores and services, schools and safety, environment and amenities, and all of the other features that generate, sustain, and enhance economic prosperity and quality of life. Due to the particular nature of the intergovernmental system in the United States, any discussion of public policy initiatives at the local level will inevitably involve various forms of federal and state government intervention, because much of the budgetary resources, taxation, and regulatory authority for municipal governments is closely interwoven with federal and state laws, grants, and other programs, rules, funding sources, and institutions.

The necessity of economic strategy and public investment for successful private leveraging

Public policies providing a wide variety of incentives and resources to promote private investment in low- and moderate-income neighbourhoods are

intended to address the causes and consequences of insufficient capital devoted to community development. One of the most essential policy approaches is to strengthen the basic conditions that help foster private market activity, such as public investment in transportation and infrastructure improvements to enhance business activity, public funding of education and workforce development to increase employment opportunities, and public support for services, training, and technical assistance that builds the managerial capacity of small and medium-sized enterprises (SMEs) and non-governmental organisations (NGOs). Indeed, it has been repeatedly demonstrated that the direct public investment approach is a necessary precondition for private businesses to thrive, which is why President Clinton's nation-wide Empowerment Zones/Enterprise Communities initiative during the 1990s provided block grants to distressed urban and rural communities for basic physical and social improvements, supplemented by state and local government funds, which were used in conjunction with tax incentives to encourage private investment. The previous wave of state-authorised Enterprise Zones created during the 1980s concentrated almost exclusively on offering tax incentives to private investors. Yet even in the cases of lucrative project-based deals where local governments sacrificed significant future tax revenues to promote private development, most of them have not worked effectively to revitalise an entire neighbourhood, unless they were part of comprehensive economic and community development strategies involving an active and extensive role for the public sector in the redevelopment process.

Indeed, far too often government officials, on the theory that any private business activity or property development project is better than nothing, eagerly subsidise private capital to invest in distressed communities, with very little to show in terms of resulting neighbourhood revitalisation and spin-off economic activity. Thus, leveraging private capital must be recognised as a potentially valuable tool to achieve important public policy objectives, but it must not be treated as its own goal. Leveraging can only be useful if it is well planned in the context of a broader economic strategy.

Such a strategy must recognise the following realities: 1) an individual urban community can only be improved if it is connected to and benefits from the larger economic dynamics of the entire metropolitan region; 2) the key to generating and sustaining economic value is building on strength by investing in the fundamental assets that make a community special and competitive, and the most important asset is the people who live and work in that community; 3) promoting new development must be tied to attracting and retaining businesses and jobs, and to attracting and retaining a mixed-income residential population. Thus quality of life issues such as a safe and attractive environment, good schools and homeownership, good transportation and communications,

may be more important than financial incentives for encouraging private investment; 4) the best way to attract and retain businesses and jobs is by fostering and sustaining the growth of dynamic industry networks or clusters that generate productivity and innovation. Incentives should be expressly targeted to move forward such an agenda, rather than simply subsidising any and all types of business and property development activities.

A good example of a community economic development strategy that used these lessons well is the NoMa initiative in Washington, DC. NoMa, which stands for North of Massachusetts Avenue, is an area near the city's downtown with a large amount of vacant land and abandoned industrial buildings, surrounded by several residential neighbourhoods populated mainly by low- and moderate-income African-American families. At the heart of NoMa is a passenger and freight rail corridor, along with several major traffic streets. Washington, DC's 1998 strategic economic development plan – *The Economic Resurgence of Washington, DC: Citizens Plan for Prosperity in the 21st Century* – targeted NoMa for redevelopment as a technology, media, arts, and housing district, taking advantage of such key assets as centrality of location, transportation accessibility, availability of development sites and loft-style structures, "broad-band" fibre optic cable lines under the railroad tracks, the role of the nation's capital as an international media centre, the 1990s boom in information technology and telecommunications throughout the metropolitan region, and the urban lifestyle that is so attractive to talented and creative young artists, multimedia professionals, and technologists.

A major linchpin of the overall strategy is the construction of a new Metrorail station at New York and Florida Avenues, NE, the first new station added since the regional transit system was planned in the 1960s, and the first-ever "infill" station built on an existing line between two stations while the trains keep running, rather than as an extension to the end of the rail line. As co-ordinator of the city government's economic development strategy during 1997 and 1998, I conceived of an innovative form of private leveraging to finance construction of the New York Avenue Metro Station. What made the necessity for entrepreneurial public sector innovation even more important was the fact that at that time, the city government was facing serious budget problems, and the city's economy was stagnating. Both of them urgently needed a major turnaround.

To help facilitate this economic and fiscal transformation, we turned to the private sector, presenting them with an attractive economic plan that would clearly make their property more valuable for development, as long as it became transit-accessible, which, for example, is a legal prerequisite for obtaining federal government office leases. After more than a year of joint negotiations

during 1997 and 1998, a group of major private property owners agreed collectively to pay $25 million through a 30-year special property tax assessment to build the transit station, and also agreed to donate land to the Washington Metropolitan Area Transit Authority needed for constructing the station.

Armed with this unprecedented large-scale commitment of private leverage, the cash-strapped city government was able to obtain $31 million in federal funds to supplement both the $25 million private sector contribution and the city's own $34 million share of the costs. This $90 million total included a pioneering public-private partnership agreement with environmental advocacy groups to build a pedestrian and bicycle path, part of the regional Metropolitan Branch Trail, as an integral component of the New York Avenue Metro Station project, thus ensuring that transit-oriented development would also be environmentally sustainable development.

There are two key points to highlight about this successful leveraging of private investment in NoMa. First, the private sector invested primarily because the city's economic development strategy for the NoMa area clearly reflected genuine market opportunities for profitable business activity, and because of the demonstrated public sector commitment to making substantial investments in the neighbourhood, which in addition to the New York Avenue Metro Station, also included $100 million in federal funds for the new national headquarters of the U.S. Bureau of Alcohol, Tobacco, and Firearms on vacant city-owned land directly adjacent to the Metro station, and an equivalent amount for a major new office complex nearby anchored by the U.S. Securities and Exchange Commission. The NoMa economic strategy was designed to generate more than one billion dollars of total public-private investment and over 5 000 permanent jobs in NoMa by the time the Metro station opens in late 2004, and these highly ambitious goals now clearly will be surpassed. The NoMa area, home to Cable News Network, Black Entertainment Television, National Public Radio, and Atlantic Video, has recently attracted other major media companies such as XM Satellite Radio and Gannett Publications. Since 1998, NoMa also has begun serving as a magnet for numerous global telecommunications firms, though many of them are suffering from the current market recession.

Second, leveraging private investment in transit and economic activity was closely intertwined with a strong community development strategy designed to involve and empower neighbourhood residents in improving their homes, schools, and amenities, and to enable them to obtain a share of the growing numbers of jobs and business opportunities coming into the NoMa area. This strategy included creation of the McKinley Technology High School and Campus in the heart of the neighbourhood to create career opportunities in

technology fields for African-American youth and adults; the NoMa Community Outreach and Marketing Centre to provide business assistance, job placement, and other important services to neighbourhood residents, and to strengthen the emphasis on grassroots participation and citizen opportunity; the designation of the neighbourhood commercial district along North Capitol Street as a Main Street Corridor for physical improvements, business promotion, and community marketing; and the development of a major shopping centre featuring the first Home Depot in Washington, DC, creating hundreds of new job opportunities and convenient low-priced goods and services for people living and working in NoMa.

In June 2002, the NoMa initiative was recognised as one of the world's 40 most exemplary models of sustainable community economic development and public-private partnerships by the United Nations-Habitat Best Practices Awards Program. Similarly, during November 2002, the NoMa initiative was selected as one of the 99 nation-wide semi-finalists by the Ford Foundation and Harvard University for the prestigious Innovations in American Government Award. The five-year track record of successful accomplishment by the NoMa initiative is definitive proof that when policymakers produce a clear and practical economic plan based on a strategic vision of strengthening the fundamental assets and dynamic industry networks that make their place special, attractive, and competitive, they can successfully leverage hundreds of millions of dollars in private investment and development activity.

Why incentives are needed and when to use them

Simply put, private capital will go where it can get a relatively secure return of acceptable proportions. Private investors and entrepreneurs are not in the business of deliberately losing money. Where they perceive market opportunities to be lacking, or that risks are too great relative to the potential payback, they will go elsewhere with their financial, physical, and human capital. In order to level the playing field and make private investment sufficiently safe and attractive, government agencies and philanthropic organisations with public policy goals that are at variance with current market realities must design and provide financial incentives to lure private capital into distressed communities. If the barrier is high risk, then such risks can be reduced through credit enhancement mechanisms such as loan guarantees or subsidised insurance. The Small Business Administration has made guaranteed loans a standard feature of its portfolio to induce banks to lend to small and medium-sized enterprises (SMEs), and the Federal Housing Administration's pioneering mortgage insurance program – in which the federal government insures private lenders against potential loss from making home mortgage loans

to qualified borrowers – has played a major role in promoting affordable homeownership in urban neighbourhoods since the 1960s.

Similarly, if the barrier is the perceived lack of a market, then guaranteed demand is an appropriate solution. The U.S. government's Section 8 program guarantees that residential property owners will receive monthly "fair market" rental payments on behalf of eligible low-income tenants participating in the program. For two decades the Section 8 New Construction and Substantial Rehabilitation programs provided long-term advance commitment contracts as a means of making it predictably profitable for property developers to build or renovate affordable housing in distressed communities, and as a means of enabling them to obtain private financing from lenders and investors. However, a problem arose after 20 years, when these legal affordability requirements expired, and some building owners decided to substantially raise their rents or convert their buildings to luxury for-sale condominiums, which then forced the U.S. Department of Housing and Urban Development (HUD) to offer these owners substantial additional subsidies simply to prevent the wholesale displacement of low-income renters.

Another example of this type of guaranteed demand-oriented leverage emerged in the mid-1990s, when HUD used specially authorised Section 8 commitments as an incentive to draw pension fund capital into investing in the construction of affordable housing. One hundred million dollars of Section 8 guaranteed rent commitments were reserved for pension funds that then competed for these Section 8 resources by investing millions of dollars to build new housing for lower income tenants. Similarly, the Clinton Administration's Hub Zones initiative provided targeted procurement for small businesses in distressed communities, thus creating a stronger market for them to sell their products and attract private capital to establish and expand their companies. The Hub Zones effort was an outgrowth of court decisions that made it more difficult to engage in targeted federal procurement for groups of people rather than for particular neighbourhoods in need, though numerous state and local governments, depending on the jurisdiction, do not face such constraints either on their people-oriented or place-oriented procurement efforts. Governments at all levels, as well as private employers and foundations, often utilise targeted procurement strategies – purchasing goods and services from small and medium-sized businesses operating within neighbourhoods in need of revitalisation – to strengthen market opportunities and provide a more secure environment for private investment. Generally only a portion, and always not more than half, of any state or local government's total procurement activity is specifically targeted by people or place, and thus the majority of such government procurement is left open for general competition from all qualified bidders.

If the barrier is lack of profitability due to the high costs of doing business in distressed communities, then policymakers can change these cost dynamics by providing subsidies to private firms in the form of below-market interest rate loans; direct grants; subordinated debt, or public loans that take a second or third position behind private lenders; equity investments on especially favourable terms; substantially reduced prices and rents for the sale or lease of land, buildings, and equipment; and tax deductions or credits. Depending on the level of priority, sometimes complex public financing packages involving multiple forms of these and other subsidies are provided. In order to justify such expenditures, public officials occasionally engage in economic analysis to demonstrate that without such government subsidies the private sector clearly would not invest, and thus public incentives are needed to leverage private capital.

For example, during the 1980s HUD's Urban Development Action Grants (UDAG) program, which provided grants to local governments for the express purpose of leveraging private investment for urban economic and community development, required applicants to clearly demonstrate with credible financial numbers the "but for" rationale behind their request for government support, documenting that the project could not be privately financed and would not get developed without the help of partial public funding. The level of subsidy and complexity of financing can become so great that it may require long and difficult negotiations to determine public support and reach an acceptable agreement. Government agencies at all levels – federal, state, and local – need experienced professionals who specialise in this type of financial and economic analysis to serve as members of their team, either as staff or consultants. Increasingly career training is being provided for such skills, both through university degree programs, and professional organisations like the International Economic Development Council, the Urban Land Institute, and the National Development Council.

If the barrier is that financial transactions costs are too high, financing deals are too small for major institutions, and community development loans and investments are too unfamiliar for the comfort level of mainstream firms, then the solution is to create intermediaries that specialise in economic and community development financing to work as advisers to and partners with private investors and financial institutions. These intermediaries can be either government agencies or non-profit private entities. In the U.S., groups such as the Local Initiatives Support Corporation, the Enterprise Foundation, the National Community Development Initiative, and the Neighbourhood Reinvestment Corporation, have effectively served as intermediaries between private capital and community developers. Indeed, they are directly responsible for the successful implementation of numerous targeted government initiatives

and programs, including federal Low Income Housing Tax Credits, which are administered by state and local governments according to an annual federal allocation formula. The above-named groups and other non-profit intermediaries not only work with private investors and financial institutions to lower their costs and reduce their risks by packaging loans and investments for them, but they also do the same for community development groups, providing both financial support and technical assistance.

Indeed, as with government economic development officials, private financiers who specialise in community economic development and non-profit community developers increasingly need highly professionalised training to empower them in their challenging work. To supplement university programs in business management, public policy and administration, and urban and regional planning, community development intermediaries play an important role in providing education and training courses, both for those who provide private financing and for those who need and use these funds to revitalise neighbourhoods. Non-profit community-based economic development in the U.S. is generally much more difficult and challenging than standard market-rate financial deals for business or real estate activity. Instead of one or two sources of financing that characterise a normal deal, investing in distressed communities may require up to a dozen different sources of funding for a development project to be fully financed. Handling such financial obstacles with professionalism and technical expertise is a constant problem for neighbourhood groups, which is why capacity-building activities are an essential element of the overall process, and a necessary prerequisite for leveraging private capital.

I co-ordinated a city-wide competition in Washington, DC for the city government's Department of Housing and Community Development (DHCD) during the first three months of 1998. At that time DHCD was responsible for disbursing a substantial backlog of funds – $70 million to be exact – for economic and community development and affordable housing and homeownership targeted to the city's low- and moderate-income neighbourhoods. My team was given the task of turning around a city government department that had been very poorly managed and was facing severe criticism for its past failures. DHCD's general approach to funding, which had become highly politicised by local elected officials, was to provide loans rather than grants to community development organisations, on the theory that loans were more "business-like" and the repayments could be recycled for further public investment. Unfortunately, the reality was far different than the theory. DHCD had no serious loan underwriting process, and consequently many of the borrowers were unable to complete their projects, their businesses became insolvent, and they defaulted on their government loans. More shocking

was the fact that even many financially solvent borrowers simply refused to repay their DHCD loans, because they believed that the city government would be reluctant to take legal action against them. As a result, in our first few months on the job we were forced to write off as uncollectable more than $50 million in bad loans. But the worst part of this situation is that there was almost no private financing leverage in most of these city government-funded deals. Detailed research we commissioned documented that each dollar DHCD provided leveraged on average only 70 cents in other private funds, which was an abysmal record.

Under DHCD' new city-wide funding competition initiated January of 1998, we designated "leveraging private financing" as one of the three main criteria for obtaining funds, along with "project feasibility" and "visibility/impact/benefit." We required all applicants for funding to demonstrate a minimum of two-to-one leverage (two private dollars to one public dollar), making it clear that higher leverage would make their proposals more competitive and thus more likely to be funded. We also insisted that all applicants demonstrate to us that they had actual money in the bank, or official commitment letters from lenders, grantors, or investors, before any private leverage could be counted on their behalf in the competition for funds. These actions on our part succeeded in generating even more private leverage than we were initially seeking. The $70 million in funding we awarded to the winners of the competition leveraged an additional $230 million in private financing, more than a three-to-one ratio. In addition, we drastically reduced the number of large direct loans made by our department, instead choosing to make smaller grants that leveraged large direct loans made by private financial institutions, on the theory that these lenders would utilise stricter and more market-oriented underwriting criteria, and that the community borrowers would be much more likely to repay a private institution.

Expanding private leverage became the key to generating a total of $300 million in public-private investments for Washington, DC's low- and moderate-income neighbourhoods, the largest single investment of its kind in the city's history. This infusion of substantially leveraged public-private capital produced several thousand new jobs, 2 000 new and renovated affordable homes and apartments, 1 500 affordable homeownership opportunities, 16 revitalised neighbourhood shopping areas and business districts, and over 50 community services centres, including health care and child care, arts and culture, education and counselling, job training and placement, parks and playgrounds. Indeed, the turnaround was so successful that even though at the time we took control of DHCD in the fall of 1997 it was under federal government investigation and subject to considerable media and public scandal for not having spent millions of dollars in federal funds received under the

block grant program for economic and community development (CDBG) and the block grant program for affordable housing and homeownership (HOME), by the spring of 1998 – just six months later – DHCD received special recognition from HUD for having created an excellent national model for fair, effective, and highly leveraged economic and community development funding, with widespread citizen participation both in the decision-making process and producing real results.

To cite just one example of strategic leveraging from the 1998 city-wide local government funding competition in Washington, DC, a solidly established community development group, the United Planning Organisation (UPO), came to DHCD with a request for a $1.25 million loan. This group already had saved $250 000 in equity to spend on building a $1.5 million community services centre in an area of southeast Washington called Anacostia. This centre's purpose was supporting and empowering predominantly African-American low- and moderate income neighbourhoods by providing health care, child care, education, job training and placement, recreation, and other vital services. However, UPO could only obtain a bank loan for $1 million, which left them with a $250 000 funding gap. Under the previous leadership, DHCD would have simply provided UPO with a government loan for $1.25 million. To the UPO leadership's surprise and dismay, however, we rejected their request. Instead, we proposed a very different and much more highly leveraged deal. We told them that they should secure an official commitment from the private bank for the $1 million loan, and having obtained this bank loan commitment, they could come back to us and request a $250 000 grant. Fortunately, this very well managed community development organisation did take our advice, and their proposal succeeded in obtaining the requested $250 000 in grant funding through the city-wide competition. The project got built and is doing very well today. The city government saved $750 000, which then became available to fund other projects, and we effectively leveraged $1.25 million in private capital for strategic community development, ensuring through the loan underwriting process conducted by a reputable bank that the project was solidly feasible. The loan is currently being repaid in a timely fashion to the bank, and the city government's grant money was well and efficiently spent.

Another key challenge for government to promote private leverage is to generate new financial instruments that will induce private investors to put their capital into economic and community development and affordable housing activities that would not normally engage their interest. In this case the barrier is lack of a proper vehicle that provides an attractive risk-adjusted return, and the solution is to create such a targeted vehicle. In the U.S., limited liability partnerships or syndicates, which protect a certain group of private investors from the broader financial risks and exposure faced by general or managing

partners, have been established to enable investment vehicles to attract capital for affordable housing, small business development, brownfields redevelopment, and other challenging public policy priorities. These limited partnerships spread financial benefits to investors through a steady and predictable income stream of government subsidy payments or tax advantages. For example, non-profit groups that pay no federal income taxes engage in "syndication" by selling their allotment of Low Income Housing Tax Credits to high-income corporations and individuals who use these credits to offset their income tax liabilities. By selling the tax credits, the non-profit groups obtain additional financial resources to use as equity to build affordable housing projects, and the purchasers of these tax credits are able to substantially reduce the amount of income taxes that they owe to the federal government. For the past 15 years, syndication of federal Low Income Housing Tax Credits has been the main method of raising private equity capital for building affordable rental housing in the U.S.

The sale of tax-exempt government bonds by state and local government to borrow funds for economic and community development projects, using such debt instruments as Industrial Development Bonds or Tax Increment Financing Bonds, is another means of pooling risk and attracting private capital for targeted economic and community development projects. In these cases private investors obtain significant reductions in their federal, state, and even local income tax liabilities, in exchange for providing vitally needed capital to the public sector for investing in infrastructure and subsidising private development to create jobs. The purchasers of these bonds, in addition to the substantial income tax benefits they receive, also derive a significant stream of income from the state and local government bond issuers through the regular repayment of principal and interest on the debt. Often groups of these loans or investments are packaged together to further reduce risk, and then sold as a bond or other form of security with a predictable stream of payments to private investors seeking a certain level and type of return for their investment portfolios.

Secondary markets, as they are called, can be very effective in expanding the range of institutional and individual investors that will provide private capital for selected activities. In such circumstances, financial institutions purchase large numbers of debt instruments from public and private lenders and borrowers, providing an immediate infusion of funds – enhanced liquidity – to the sellers. They then repackage these loans, which carry a regular stream of loan repayment income, and sell them as securities to individual and institutional investors, thus drawing a larger pool of private capital in support of a particular form of community development or housing finance that would not otherwise attract such capital investment, because the securitisation of the loan packages and bonds have significantly pooled and thereby lowered the risk, as

well as substantially reducing the transaction costs. Fannie Mae and Freddie Mac, two nation-wide secondary mortgage market entities that securitise home mortgage loans by purchasing them from mortgage lenders and selling these securities in institutionalised capital markets, have attracted literally trillions of dollars over the past three decades to increase capital availability and lower the financing costs of homeownership in the U.S. Government agencies, financial institutions, and philanthropic foundations have worked together on a smaller scale to create secondary markets for economic and community development loans and investments in distressed neighbourhoods, such as the nation-wide Community Reinvestment Fund, a non-profit organisation supported mainly by foundations and corporations, which purchases community development loans from state and local government and non-profit community development financial institutions (CDFIs), packages these loans together as securities, and sells them to investors through "private placements" (not through securities brokers or institutionalised capital markets). Establishing a secondary market of community development loans is much more difficult to create and sustain than the huge secondary market in the U.S. for home mortgages, because the latter represent an enormous volume of a highly standardised product that is easily packaged and evaluated by securities rating agencies. However, state and local governments and non-profit groups can work together to establish such secondary markets and successfully identify private or philanthropic investors that will purchase a security consisting of a group of loans, but would not purchase each individual loan separately, due to the increased risks and transaction costs.

One criticism of many of these tax incentives, limited partnerships, and securitisation schemes is that a portion of the government subsidy is going to high-income investors rather than to low-income families and communities. These critics argue that direct grants to non-profit groups would be a more efficient use of funds. The advocates for private leveraging respond that without such incentives, the total amount of capital for economic and community development would be even less, because public budgets are more limited politically in the amount of direct subsidy they can provide in the absence of significant private leveraging. Similarly, tax incentives are popular with policymakers, because even though they are much less efficient as a targeted subsidy for distressed communities, they are more invisible to voters in that they are not generally subject to annual budget debates, which makes them far less politicised and thus more likely to survive as legislation once they have become well established and have cultivated a significant constituency of support from politically influential private investors.

Another type of leverage is on the regulatory side. Governments may require bidders for contracts, leases, deposits, charters, or other valuable public

benefits that, in exchange for such publicly authorised value, the private firm must invest in certain communities or partner with certain organisations to accomplish major public policy objectives. A good example is the federal government's Community Reinvestment Act (CRA), which scrutinises the loan portfolio of depository financial institutions to make sure that they are serving all of the people and communities from which they take checking or savings deposits. The CRA has been responsible for helping generate literally billions of dollars in community investment over the past quarter century. It does not require a bank to make any specific investments or to take any fiscally unsound risks, yet it does require banks to devote a portion of their loan portfolio to serving low- and moderate-income communities both for small business, housing, and consumer lending, and for other financial services such as checking accounts or ATM machines. More importantly, the federal regulators who enforce the CRA and its various companion laws including the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the Fair Housing Act, along with the local and state activists and national organisations who fight for full enforcement of the CRA – groups such as the National Community Reinvestment Coalition, the Association of Community Organisations for Reform Now, National People's Action, the National Congress for Community Economic Development, and the National Low Income Housing Coalition – have helped educate numerous private lenders about community development such that many banks now engage in voluntary efforts to expand their lending in distressed neighbourhoods, understanding that what they previously viewed as charity actually represents good and profitable business opportunities. Some private lenders and their associations in turn have become more supportive of community reinvestment activities in recent years, including Bank of America and J.P. MorganChase Bank, the Consumer Bankers Association, and the National Association of Affordable Housing Lenders.

In addition to requiring certain community-oriented private investment behaviour, government officials and programs can also give a preference to certain applicants based on their fulfilling additional public policy purposes, or governments can provide extra incentives to encourage private entrepreneurs to engage in such priority activities. For example, many local governments in the U.S. offer "density bonuses" to permit increased building height, volume, or density for property developers who build market-rate residential real estate projects if they commit to reducing the sales prices and rents of between 10 to 20% of the housing units to make them affordable for low- and moderate-income households, or for developing other desired amenities such as street-level retail stores in office buildings. Governments can also change laws and regulations to permit certain activities, like enabling banks or pension funds to invest in affordable housing and community development projects that meet their fiduciary responsibilities. California State Treasurer Philip Angelides, who

is responsible for investing billions of dollars of public employee pension money as well as other state government funds, has instituted the "double bottom line" (boost the state government's treasury at the same time as helping the state's people and communities) to increase financially sound and safe investment in community economic development and services, along with affordable housing and homeownership, and still achieve a competitive return on these investments. Pension fund managers are often biased against distressed communities due to lack of knowledge about market opportunities, and government regulators frequently need to persuade them to seriously consider such investment options as being both profitable and safe.

Finally, governments can create favourable laws and regulations allowing financial intermediaries to function for specific purposes, such as savings and loans, co-operative banks and insurance entities, community credit unions, community development banks, and community loan funds. President Clinton established the Community Development Financial Institutions Fund in the U.S. Department of the Treasury, to provide millions of federal grant dollars annually for private institutions, generally but not exclusively non-profit organisations, to enable them to substantially increase their investments and lending activities in distressed communities.

In most efforts to revitalise distressed communities in the U.S., intergovernmental relationships are a very significant factor. Often the initiative will come from a local government – city, county, town, village, township, etc. – with additional resources from the state government and the federal government. Most approaches will involve combining direct funding, tax incentives, a variety of targeted programs, and legal and regulatory authority. This mix of incentives will be drawn from multiple levels of government and overlapping jurisdictions, including special public authorities such as regional transportation agencies, and quasi-public entities such as economic development corporations or urban redevelopment authorities. And this thick stew should also include the many private sector institutions, foundations and other non-profit groups, labour unions and civic associations, and faith-based and community-based organisations that must be involved in order for urban community regeneration to truly succeed. In a report recently published by the National Governors Association (NGA) in the U.S. – *State Policy Approaches to Promote Metropolitan Economic Strategy* – I explore many of the intergovernmental issues that are important for local and regional economic and community development. Government policy, programs, and funding are all more centralised in most European countries, which may allow for an easier process of investment, though it might also be less accommodating for grassroots leaders who are attempting to organise community initiatives.

Leveraging private financing for people or places?

Since this chapter is about leveraging private financing for community development in distressed areas, a crucial issue to be addressed is what kind of investment is being encouraged in those neighbourhoods. There are many examples from the 1960s "urban renewal" era in the U.S. and around the world, where the public sector successfully leveraged private investment for commercial or residential development in distressed communities, essentially displacing the low-income population by forcing them to move to other distressed communities, and replacing them with middle to upper income employees, tourists, and residents. This process – now called "gentrification" – can occur solely through private market activity unaided by government, but much more frequently is supported and even encouraged by public policy and substantial government subsidies.

One of the problems with targeting places for development and investment and appealing to the private market to provide the bulk of the financing is that the most likely outcome will be some degree of gentrification and displacement, since market-oriented investors and developers can earn more money at less risk by targeting higher income producers and consumers. The best solution for avoiding this particular outcome while still promoting successful economic, social, and physical regeneration is to work directly with the existing low- and moderate-income population and include them as full stakeholders and partners in the planning and policy-making process that guides all of the subsequent public and private redevelopment actions. At the Prague Institute for Global Urban Development, we call this method of valuing and including everyone in contributing to the process and benefiting from the results "Treating People and Communities as Assets."

In the Clinton Administration we tried to improve distressed communities by making life better for those less fortunate who were already integral members of these communities. Very often such neighbourhood improvement efforts included a focus on attracting and retaining more of a mixed-income population. People that do not have living wage jobs needed to be provided with various forms of assistance in order to obtain the skills and opportunities for gainful employment or entrepreneurship, whether these jobs and businesses are located within their own community or throughout the region. This was the main purpose of HUD's Bridges to Work program. In addition, these low- and moderate-income residents also needed assistance with obtaining good quality affordable housing, and particularly homeownership, that can stabilise the neighbourhood as a liveable environment along the lines of New Urbanism community planning and design principles.

This was the main purpose of HUD's Homeownership Zones and HOPE VI programs. While HOPE VI is currently being downsized, it still continues to be a major federal government program to transform public housing communities. Unfortunately, under the new federal administration both Bridges to Work and Homeownership Zones are not being expanded or renewed. However, many state and local governments and private non-profit organisations at the metropolitan or community level are actively promoting similar initiatives, from the various Nehemiah community rebuilding activities based on large-scale homeownership, to a wide range of regional city-suburban jobs linkage activities.

Creating more of a mixed-income community, even if it involves attracting middle-income homeowners and workers, does not automatically mean displacing large numbers of low-income people. Good, well conceived and carefully implemented economic and community development strategies can raise incomes and increase job opportunities for low-income families; improve schools, safety, stores, services, parks, transportation, infrastructure and housing; expand homeownership and entrepreneurship; and still retain many of the current low-income residents as part of the overall mix and dynamic of neighbourhood upgrading. Achieving such a result is certainly a major public policy challenge, and leveraging private financing to accomplish this vitally important goal is definitely more difficult, requiring economic strategies and financial incentives that are based on a thorough understanding of private market behaviour and a broad view of regional assets. In other words, targeting distressed communities should be tied to a Metropolitan Economic Strategy as described in my NGA report on *State Policy Approaches to Promote Metropolitan Economic Strategy* or my United Nations-Habitat and U.S. Agency for International Development reports (also available from the Prague Institute) on *Productive Cities and Metropolitan Economic Strategy.* Private investment should be shaped by public policies that are genuinely inclusive of low-income families as contributors to, not victims of, neighbourhood revitalisation efforts.

Conclusion: linking private leverage to public policy and economic strategy

Most of this chapter is devoted to section on "Why incentives are needed and when to use them." I will not recapitulate here the pages of detailed analysis and information as to how to design and implement effective public policies that will promote substantial private investment and development activities specifically targeted toward generating increased prosperity and quality of life for lower income families and distressed communities. The key to success is to work closely in partnership with the private sector and understand their needs

and market behaviour, such that incentives will effectively induce them to make investments they would not otherwise make due to excessive risk, insufficient return, lack of institutional support, difficulty engaging in transactions, and inaccurate or incomplete information as to genuine profitable market opportunities.

Two points from earlier in the chapter do need re-emphasising here. The first is that in order to get the private sector to invest, the public sector must make a substantial investment commitment. It goes back to the old adage: "you've got to spend money to make money." In other words, to leverage "other people's money" it is vitally necessary for the public sector to use its own resources quite strategically. If governments invest wisely they will save substantial costs by effectively leveraging private funds and by producing improved economic circumstances that reduce other costs and expand public revenues. Yet all of this can only be accomplished if governments are willing to make their own investments. For example, in London, the Canary Wharf development failed until the U.K. government and London Transport finally built the Docklands Light Railway and the extension of the Jubilee Line in the underground railway system. When public investments were eventually made, private investments followed in record numbers.

Secondly, no incentive package will be worth the public commitment if it is not tied to an overall economic strategy for the community that is well conceived and well executed. Here it is worth repeating the four central points I made much earlier in this chapter: "Indeed, far too often government officials, on the theory that any private business activity or property development project is better than nothing, eagerly subsidise private capital to invest in distressed communities, with very little to show in terms of resulting neighbourhood revitalisation and spin-off economic activity. Thus, leveraging private capital must be recognised as a potentially valuable tool to achieve important public policy objectives, but it must not be treated as its own goal. Leveraging can only be useful if it is well planned in the context of a broader economic strategy. Such a strategy must recognise the following realities: 1) an individual urban community can only be improved if it is connected to and benefits from the larger economic dynamics of the entire metropolitan region; 2) the key to generating and sustaining economic value is building on strength by investing in the fundamental assets that make a community special and competitive, and the most important asset is the people who live and work in that community; 3) promoting new development must be tied to attracting and retaining businesses and jobs, and to attracting and retaining a mixed-income residential population. Thus quality of life issues such as a safe and attractive environment, good schools and homeownership, good transportation and communications, may be more important than financial incentives for encouraging private

investment; 4) the best way to attract and retain businesses and jobs is by fostering and sustaining the growth of dynamic industry networks or clusters that generate productivity and innovation. Incentives should be expressly targeted to move forward such an agenda, rather than simply subsidising any and all types of business and property development activities."

CHAPTER 4
SMALL- AND MEDIUM-SIZED ENTERPRISES

by
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Instruments to improve access to finance for small and medium-sized enterprises (SMEs) have long been neglected as a tool to stimulate regional and local development but are probably one of the best policy options. This chapter explores these issues focusing firstly on the financing paradox, secondly on the demand-side issues, thirdly on the supply-side issues and concluding with some concrete recommendations for cities and regions.

2 . The author thanks Sophie Bland and Jennah Huxley for checking the English.

Introduction

Instruments to improve access to finance for small and medium-sized enterprises (SMEs) have long been neglected as a tool to stimulate regional and local development but are probably one of the best policy options. Both the design of such a scheme and its combination with policies targeting not only the supply side, but also the demand side, could optimise leverage of private financing and further increase value for public money as well as for private money. This chapter will explore these issues focusing firstly on the financing paradox, secondly on the demand-side issues, thirdly on the supply-side issues and we will conclude with some concrete recommendations for cities and regions.

The paradox of lack of funds in an abundant market

Many economists and politicians, overwhelmed by the inflow of money into the deposit banks and the growth figures of the venture capital market in the years 1995 to 2000, claim that the problem of access to finance on reasonable terms has been solved. There is no longer an obstacle to growth and to the development and creation of enterprises from the supply side of finance. The only thing that is lacking, are good projects.

Supply side analysis

Credits

Loan finance is the most important source of external financing for most European enterprises. Lack of collateral is often the biggest problem facing SMEs. We are all familiar with the statement to get a loan you've got to prove you don't need it. In fact, the meaning of this sentence is in its use, as Ryle would say, and in this respect it is usually insufficient to prove the cost-effectiveness and the pay-back capacity of a project in order to get a bank loan. Sticking to the "you never know" principle, and arguing that money lent comes from the savings of accountholders; banks are reluctant to grant loans unless sufficient collateral is provided. Although we live in a financial environment with a high profile given to capital market funds and venture capital, the fact is that 70% of SMEs are still financed through traditional bank loans. The refusal to grant such a loan is, in many cases, a major impediment to the creation of a company and/or the financing of an investment.

Even more damaging for SMEs is the fact that banks, if they agree to finance, prefer short-term financing. A study carried out in Europe showed that in a number of countries, such as Denmark, Greece, Italy, Portugal and Spain, small enterprises do have a very limited access to long-term loans (Grant Thornton, 1999). This implies that long-term investments are often financed through short-term, commercial credits. Needless to say, such financing violates the rules of sound financial management and results in balance sheets unable to comply with the acid-test criterion (the acid-test is an accounting ratio measure of the liquidity of a firm). Moreover, the firms receiving such finance are often characterised by negative working capital.

Changing context in Europe

This situation will not improve due to the concentration phenomenon in the banking sector, the new proposals of the Basle committee and the search for higher yield. Let us have a closer look at each of these factors.

Globalisation has caused a reduction in the number of banks and the process is still ongoing. The concentration of the banking sector has created a favourable environment for a new credit-policy, which entails higher returns on capital and better guarantees. The outcome of the concentration phenomena is in line with the new capital adequacy framework as proposed by the Bank of International Payments, established in Basle. Conforming to the actual Cooke ratio, any loan to a private company needs a capital reserve of 8. A loan guaranteed by a mortgage needs only a capital contribution of 4. This means that guarantees have a positive impact on capital adequacy requirements.

The existing Basle rules made no distinction between a non-guaranteed loan given to a big corporate client and a non-guaranteed loan given to a start-up corner bakery or public house. The Bank for International Payments realised that there was a weakness in its approach and therefore made new proposals to the banking sector introducing the concept of rating. The debtor can be rated either by an external rating agency, such as Moody's, Standard and Poors or IBCA Fitch, or by an internal rating. A very good rating of a non-guaranteed loan will need only 2% capital Adequacy while a bad rated non-guaranteed loan will require six times more capital. This will result in banks adopting a new credit policy. However, most banks did not wait for new Basle proposals in order to make a closer link between risk and return. Some banks have introduced the concept of "RAROC" (Risk Adjusted Return on Capital). The return on capital will be adjusted commensurate to the risks involved in each loan.

Not only will the banking corporations be forced to adjust their equity in relation to the loans extended to their customers but also financial analysts will compare the performance of banks to those of other countries and a lower performance will be penalised by the market. Banks are not in a condition to depart from other banks with a higher performance, otherwise they will be forced to borrow on the inter-bank market at conditions higher than those of their competitors and they will not be in a position to be competitive in their relations with their corporate clients. The higher return and less capital adequacy requirements in other banking activities, such as private equity and private banking, are forcing the banks to review their loan-policies.

Towards a new loan policy

As a consequence of globalisation, the Basle rules and the tendency to higher yields, banks gradually introduce a new loan policy based on the following considerations:

- a debtor will have meet higher criteria to obtain a loan. This means that the banking sector will depart from his earlier conduct of "service public" whereby the customer was more or less entitled to obtain a loan.
- a fair remuneration compared to the remuneration of other banks. This fair remuneration comprises the cost of capital, expenses of the administrative procedure, the return on capital and an adequate risk premium covering the cost of expected and unexpected loss. A highly qualified loan will be obtained on better conditions; a lower qualified loan will be highly penalised.
- the quest for guarantees will be accelerated: better guaranteed loans require less capital adequacy and improve the bank's rating. A partial securitisation of the bank portfolio (i.e. the sale) asks for a rating and the presence of guarantees will be very helpful in obtaining better sales conditions. Alternatively, appeal can be made on efficient public guarantee schemes
- the general-purpose loans such as overdraft or straight loans, which do not permit a straight surveillance of the utilisation of the loan will be partially replaced by loans on a transaction basis whereby the bank has an immediate overview of the loan's utilisation.

Even a good customer will be confronted with a trade-off between better guaranteed and cheaper credit on the one hand and less guaranteed and more expensive credit on the other hand.

Notwithstanding this new loan policy, credit finance will probably remain in the near future in Europe the most important corporate finance tool. But the new legal frameworks and the increasing importance of institutional investors will develop a more market driven financing in Europe.

About loans and guarantees

The most important criterion for obtaining a loan resides in the capacity of the debtor to repay the loan. In addition it is easier to calculate the debtor's capacity to reimburse on a short-term basis than on a medium or long-term basis.

As far as short-term loans are concerned, the working capital gives information on a debtor's capacity to reimburse. The sale of short-term assets such as stocks and customers debts should be sufficient to refund the loan.

Solvency rates and return rates will be very helpful in the calculation of the capacity to refund a loan on a medium or long term. An undercapitalised company with low returns will have difficulties in reimbursing the loan. On the other hand a highly capitalised company with high cash flows will be in a more favourable position to refund the loan. In this context, different returns will be examined: the bottom line (net earnings), the operational return (exceptional items will not be considered), the cash flow (net earnings and amortisations) and the EBIT (Earnings before interest and taxes).

Of course, qualitative elements, such as the honesty and the competence of the debtor, will be taken into consideration as well, but these are much harder to translate into automatic scoring systems.

But in almost all cases, banks do negotiate guarantees. We can distinguish four reasons why bankers do insist on the obtention of sufficient collateral:

- the risks: risks depend of course on the risk profile of the customer. Furthermore risks for long-term credits are higher than the risks for short term credits. It means that the banks are more inclined to ask guarantees in case of long term credits compared to short term credits. Normally, in a situation of bankruptcy, all creditors will be treated on an equal basis. However the legislator has introduced a mountain of privileges in favour of particular classes of creditors (social, taxation, etc.) which will infringe the interests of the non-privileged creditors who will recover nothing or almost nothing. When other banks have collateral they will contribute to a further worsening of the situation of the non-privileged banker.

- capital adequacy: as it stands today, guaranteed loans are less demanding in capital adequacy requirements compared to non-guaranteed loans.
- securitisation: guaranteed loans will improve securitisation conditions.
- refraining other banks to put loans at the debtor's disposal: when other banks are observing that the land has been mortgaged and the assets have been pledged in favour of the initial bank they will be less willing to provide loans to the client.

Formal and informal venture capital

As credits become hard to obtain, especially for starting companies, risk capital could be the solution. Venture capital funds (formal venture capital) have indeed been mushrooming. The strong development of venture capital can be illustrated by the fact that the sector grew between 1995 and 2001 by an average of 45% (EVCA, 2002). Business angel financing (informal venture capital) has been stimulated through the development of business angel networks. The number of networks rose form 51 in 1998 to 158 in 2002. The average number of deals by networks remained constant at around 10 deals per network. Moreover, one can suppose that the number of deals through the networks is only the tip of the iceberg. It is generally agreed, therefore, that there is no generalised problem of lack of capital. Unfortunately, however, this does not mean that companies have easy access to finance, especially during the start-up phase. Numerous surveys confirm that lack of financing is still considered one of the major obstacles for start-ups, for growth and for development, particularly in less favoured regions or distressed urban areas.

Some surveys

To illustrate this thesis I quote two surveys. The first is based on an inquiry into 50 000 SMEs in Europe (Grant Thornton survey, 2002) and the second concerns the findings of the European Observatory for SMEs (ENRS, 2002). In both cases and in almost all countries, lack of financing was reported as one of the main obstacles to enterprise creation and development, either the lack of internal and external financing or the cost of it, and is more acute for early-stage enterprises. Indeed, venture capitalists generally turn away from the riskier market of early stage enterprises and loan finance remains the most important source of external financing for most European enterprises. However, the fact of having credit (the percentage of enterprises having a loan in Europe varies from 45 to 75%) does not prevent many enterprises from feeling constraint in their access to finance as the volume of credit is often insufficient or the conditions

are unsatisfactory (Aernoudt, 2000). It goes without saying that recent market developments, such as the earlier discussed concentration in the banking sector and the anticipation of the Basle II agreement, as well as the implosion of the internet bubble and the increased difficulty of exit through initial public offering increases the financing problem for SMEs.

At a regional level, different studies (Aernoudt, 2002) show that one of the major preconditions for ensuring development is to offer various financial resources, such as loans, factoring, leasing, venture capital and business angels; and to ensure sufficient interaction between these different partners. At the same time, difficult access to finance for SMEs is considered one of the main obstacles to the development of a region (Bank of England, 2002). This is a sufficient reason for each region that aims to promote its development to tackle the lack of supply of sufficient financing on reasonable terms and conditions.

We can conclude that, despite the abundance of funds on the financial markets, European SMEs are faced with financing problems, which seriously hinder their start-up and their growth.

Demand side analysis

The conventional debate regarding financing applies what is known as Says' law and centres on the availability of funds, presuming that demand is a latent force, reacting passively to supply. We have already argued that supply is far from optimal. However, it could also be argued that demand conditions do matter and that the pool of entrepreneurs seeking financing may in fact be limited. Entrepreneurs, and especially starters, do spend a lot of time looking for finances to start and develop their business. Their financial need is mostly expressed in the amount of money they need, and to a lesser extent, the time they will need it for and/or the payback period.

Preference for credits

The preferred option entrepreneurs take is to see if they can finance the project through their own resources, generated by the cash flow in previous years. They know their business better than anyone else does and they avoid administrative procedures otherwise necessary to convince an external person to lend or to invest money in the company.

Academicians call this the information asymmetry argument. It is only thereafter that they turn to external financers and bankers in the first place, as

they do not interfere in the business as long as the credit is paid back at the agreed deadline. Finally, and confronted with the lack of collateral and a low level of solvency, entrepreneurs go for external equity. Formal venture-capitalists, and *uberhaüpt* business angels are considered as lenders as a last resort. The preference for self-financing over debt finance, and for debt financing over equity, has empirically been confirmed and is known as the pecking order theory.

Venture capital as last option

Demand for venture capital therefore depends on the entrepreneurial sector, which consists of those able and willing to take and manage risks. Moreover, it could be argued that entrepreneurship may be influenced by environmental factors such as social, cultural and political background. Therefore, demand for venture capital is dependent on entrepreneurial activity and influenced by the willingness of entrepreneurs to open their ventures to external equity finance.

Entrepreneurs should consider that not all money is the same. They should take into account several criteria when they are considering different sources of finance for their ventures (Denny, 2000). To achieve successful and profitable business development it is necessary to ensure that the right type of money is matched to the real risk involved. For a start-up, with no income until the product is fully developed and the first sales are made, debt finance is rarely the best source of external finance. Debt finance is usually secured on assets. The longer or more uncertain the period to exit is, the higher the collateral that is required. Moreover, the riskier the project is, the higher the anticipated reward that will be needed in order to attract investors.

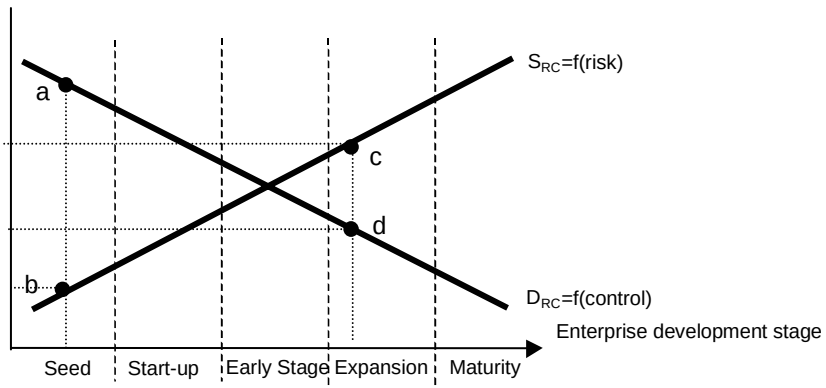
Entrepreneurs oriented towards the future and growth may therefore be able to convince venture capitalists to invest in their project. Most of the literature agrees that the positive correlation between venture and economic performance becomes more evident (OECD, 2000). Refusing such backing may impede growth. Gazelles cite the fact that at a certain stage they no longer seek internal financing, but prefer external participation as an important element in their strategy (Crijns, 1997). However, most European SMEs prefer short-term considerations and the entrepreneur therefore often prefers to remain “the boss of a small company” rather than the “manager/shareholder of a big company” (Katz, 1999). A lifestyle entrepreneur is essentially concerned with creating an income for themselves and a lifestyle for their families (Birch, 1993). In these cases, the venture capital market will be less appropriate than the banks and/or other sources of funding.

Besides, there is an information gap between the demand and the supply for funding, due to the fact that entrepreneurs do not fully understand the range of financing options available, nor do they understand the consequences of certain types of finance. There seems to be a certain amount of luck or chance involved in the search for funding (Manigart, 2001). But even professional business advisors that work with SMEs do not always fully understand the range of options available in terms of financing. Therefore they do not fully guide their SME clients to understand the implications of different sources of financing (for example what the benefits of bank versus venture capital are), nor do they point out the weaknesses of different sources of financing.

The paradox explained

In order to explain the paradox, we will focus on start-ups where the financing is the most accurate. Bankers are not very eager to lend money to starters given the high risk involved. Therefore entrepreneurs turn to venture capitalists. The demand and supply analysis allows us to explain the paradox mentioned earlier. Ironically, in the seed and start-up phases where suppliers display the least interest because of high costs and low returns, entrepreneurs are more receptive to external finance. In the expansion and maturity phases, where venture capitalists become more interested in investing in the company, external finance becomes less appealing to the company. The different elements put together can be illustrated graphically as follows:

Figure 4.1. **Simple analytical model of supply and demand for venture capital by enterprise stage**



The interest for venture capital is larger in the seed and start-up phase than for the later stages. Control is felt as an impediment for opening to venture capital less in the start-up stage than in a more advanced firm and the benefits of management assistance are considered significant. For the same reasons, demand for venture capital decreases as the company grows. On the supply side of the market we see the opposite. Venture capitalists try to avoid the risks and prefer large-scale, less labour-intensive deals to the riskier phases.

Therefore, seed and start-up investments still encounter huge problems in finding venture capital (ENRS, 2002). They are in a seller's market (a>b). The few remaining venture capitalists operating in this segment of the market use their oligopoly position to request a higher return premium and apply stringent rules. A survey indicates that the desired return on seed investments is estimated at 100% for the seed phase compared to only 25% for the development stage (Leleux, 2000) and that they are very rigorous in selection and due diligence. Realised return on seed investments remains, however, lower than on the less risky development investments (EVCA, 2002). The classical risk-return relationship (the more risk one takes, the more return he gets) doesn't function and we are here confronted with a market failure. Lack of transparency and the absence of sufficient suppliers on the lower end (seed and start-up phase) impede perfect competition and hence market forces are not capable of restoring an equilibrium situation. Nowadays venture capitalists and policy makers both agree that the market does not work well at the "lower end", i.e. the seed capital/early stage levels of investment where the perceived risk to an investment is high relative to the expected return (Lawton, 2002).

On the other hand, as venture capital markets have been booming and fundraising has been easy, venture capitalists have been "desperately" looking for projects to invest in the expansion phase. In the expansion phase (fourth-round financing), only a few companies are interested in opening their capital to venture capital funds. Given that most of these companies generate cash flow, and in conformity with the empirically confirmed picking order theory, companies in their expanding phase prefer self-financing and credit-financing to risk capital. Risk capitalists and fund managers, sellers of money, prefer these expansion investments and, given the buyer's market (c>d) they have to reduce their conditions. If venture capitalists want to find projects, they will have to accept a lower desired return and adopt an investment strategy that involves less control over day-to-day management. Therefore, not only the lower risk position, but also the bargaining position makes it easier for a company to obtain venture capital under favourable conditions for expansion financing.

It is only in the (late) early stage that entrepreneurs and venture capitalists can conclude a deal in competitive market conditions. Venture capitalists should

not try to exploit the information asymmetry problem (meaning that they ask a premium based on the argument that they never have the same information on the project as the entrepreneur) in this context and growth-oriented entrepreneurs should seek to benefit from the opportunities offered by the venture capital market rather than invoking the loss of control in order to justify their unwillingness to open the capital. One could of course argue that the lower desired return only reflects the lower risk linked to the development stage of the company. However, the very high differences cannot only be explained by the traditional risk premium theory. The market structure and the accuracy of the information asymmetry are other elements to be taken into account. The desired return might correlate more with the investor's bargaining position than with his risk position. Although there is still insufficient empirical research on this field, the following table may clarify this position.

Table 4.1. **Simple analytical model of firm development and desired return**

Development stage	**Seed**	**Start-up**	**Early stage**	**Expansion**	**Mature**
Desired return	80 – 100%	40-70%	30-40%	25-30%	20%
Market structure	Mono / oligopoly	Oligopoly	Competition	Oligopsony	Mono / oligopsony
Risk level	Very high	Rather high	Normal	Limited	Very limited

Source: Adapted from Leleux (2000).

Therefore, although high growth-oriented entrepreneurs are equity-minded in their start-up phase, they are faced with serious difficulties in obtaining venture financing in acceptable conditions. Consequently, only one in every three thousand starters actually concludes a start-up deal with a venture capitalist. On the other hand, entrepreneurs still consider external equity the third best option. This means that, the first choice of financing is through retained earnings, followed by external debt.

This approach makes it possible to understand why a large share of venture capital is oriented towards management buy-out (MBO) financing. Entrepreneurs have no choice as both collateral and self-financing are missing. Suppliers have (almost) no risk as the track record is proven, but nevertheless try to achieve a high return based on a well-structured deal. At the same time it explains why bank financing remains by far the most important source of financing and the lack of collateral by far the biggest impediment to SME development. Moreover, the use of conventional banking criteria excludes

micro-borrowers, young people, ethnic minorities and environmental projects from traditional bank finance (European Commission, 2000b). This position on ethnic minorities was confirmed by a special report of the Bank of England concluding that among ethnic minority businesses access to finance was particularly difficult (Bank of England, 1999).

From the above analysis, we can easily understand that financial constraints are felt to a much greater extent by starters and fast growers than by slow growers, as confirmed by the survey by the European Network for SME research (ENRS, 2002). But starters and fast growers are exactly the kind of firms that are badly needed to promote local and regional development.

Table 4.2. **Financial obstacles to growth**

Enterprises	Starters	Slow growers	Innovative	Strong growers
Financing as major obstacle	22%	8%	16%	19%
Bank credits as major obstacle	40%	40%	47%	50%
Bank guarantees as major obstacle	33%	37%	44%	48%
Personal guarantees as major obstacle	25%	26%	36%	39%
Guarantees on fixed assets as major obstacle	4%	5%	5%	7%

Source: ENRS (2002).

Summarising the different challenges

The second bankers' round table, organised by the European Commission in the year 2000 implying high level bankers and SME organisations, in order to identify best practices and make recommendations to improve relations between banks and SMEs, concluded that banks charge too much for loans, are too risk-averse, require too many guarantees and prefer short-term lending (European Commission, 2000b). One of the reasons for this reluctance on the part of bankers in the European Union is the lack of own funds in SMEs, partially caused by the equity gap. The equity gap, together with the associated confidence problem, puts European enterprises at a competitive disadvantage compared to the United States, as can be seen from Table 4.3 based on the average of all published European and American balances (BACH database).

Table 4.3. **A comparative assets and liabilities structure**

	European Union	United States
1. Own Funds	32%	46%
2. Loans > 1 year	17%	28%
3. Permanent Capital (1+2)	49%	74%
4. Short-term Loans	51%	26%

Source: European Economy, September 97, and own calculations (Data: average 86-95).

The table shows own funds, long-term credits and short-term credits as a percentage of total financing sources, excluding commercial credits. While one-quarter of these financial sources have a short-term character in the United States, one-half of them are short-term in the EU. In other words, the share of short-term loans as a source of funding is twice as big in the EU as in the United States.

By dividing long-term loans by total loans, we get what financial economists call the banks' confidence ratio in enterprises. Applying this rule, the confidence ratio in the United States is 51%, compared to only 25% in the European Union. It is worth noting that these data do not come from a complex extrapolation of data or complicated regression analysis, but are simply based on a linear aggregation of data from a database of all published balance sheets of European and American enterprises. It is not surprising that by far the biggest reason why an SME is not able to access bank finance is the inability to put enough of its capital into the business (Bank of England, 2002).

Therefore, four components of the financing gap can be distinguished:

- the venture gap, mainly for pure equity, focusing on high potential growth, innovative and young firms

- the risk capital gap, applying to moderate growth firms looking for equity to mezzanine financing (meaning quasi-capital such as subordinated loans) for an amount varying from euro 100 000 to euro 1 000 000, also called the small equity gap, estimated at 200 000 firms a year (Bannock, 2002)

- the confidence gap, explaining the reluctance of bankers and their preference for collateral

- the investment readiness gap, based on the lack of understanding by entrepreneurs of the functioning of the different sources of finance, implies that entrepreneurs are not eager to take an investor on board

Policy implications: plead for a mix of financial instruments

Government policy to stimulate regional and local development must consider access to finance a priority. Therefore, a region should try to develop different instruments as they all have their positive and negative aspects for the creation and development of firms. We could summarise their characteristics as follows:

Table 4.4. **Comparative analysis of the different forms of financing**

	Pros	**Cons**
Friends, Family & Fools	- Easy to obtain - Patient	- Limited added value - No deep pockets
Public Sources	- Free - Patient	- Bureaucratic - Slow, hard to locate
Banks	- Potentially cheap - Relatively fast	- Unpredictable - Require security, impatient
Business Angels	- Fast, non-bureaucratic - Business understanding	- No deep pockets - Often not systemised
Private Equity	- Deep pockets - Value-added easy to ascertain - Clear agenda	- Potentially unpredictable agenda - Potentially slow - High expectations - Difficult to obtain

Therefore, we will now look at how leverage can be created with the private sector in order to cope with the supply constraints identified above and to ensure the availability of a range of different financial sources. In order to enhance the involvement of these different categories of finance, suitable mechanisms should be developed, where the government should take an initiating role, while leaving the decision at project level to the private sector. Moreover bureaucracy should be avoided and transparency in the decision process is crucial. Here we see the main role for local government as ensuring accurate information and creating awareness on the one hand, and setting up incentives to generate leverage with the private sector on the other hand, by co-investing with or guaranteeing, the private sector involvement.

Every effort has to be made to tackle this problem. Too often we see that policies are either focused on making access to capital markets easier, or are oriented to the credit segment of the financial market. A city or region government or development agency should try to find an optimal combination of own-resources-oriented policies on the one hand and credit policy on the other hand. The fiscal and regulatory environment should be attractive for all financial solutions and not interfere in the choice of financing. Too often the fiscal system has privileged external financing over attracting new own sources. However, we must also not end up in a situation that, as a result of overshooting, privileges business angel financing or formal venture capital financing over credit financing. The fiscal environment should create a neutral space for the development of the different financial instruments in such a way that an SME can, at any time, calculate what is the most suitable solution based on arguments which are linked to its balance structure rather than to fiscal advantages. The same philosophy should be respected in the attempts to simplify the regulative environment for SMEs in relation to their access to finance.

Direct actions in order to stimulate venture capital should go hand-in-hand with direct actions aiming to facilitate the access to loans. Following the same line of thinking, we can argue that the asymmetry of information between the risk capitalist and the SMEs, often resulting in the deal not taking place, has its counterpart in the often complex relations between banks and SMEs. In both fields, loans and venture capital, actions should be taken that lead to a better understanding between the partners involved. Of course, depending on its capital structure and stage of development, one instrument might seem much more appropriate than another. At a later stage, due to family changes or other reasons, a different method of financing might be necessary. Moreover, contrary to what some models might suggest, there is a possible synergy between the different instruments. The participation of a business angel might mean that the formal venture capitalist becomes less reluctant to step in, as he knows that the business angel will assist the manager. This might lead a financial institution to grant credits as the own funds are sufficiently increased, guarantees become available and the business plan becomes more solid after the involvement of the business angel.

Therefore, the best guarantee for cities and regions to achieve the objective of easier access to finance for local SMEs is to create a favourable context for the development of the different instruments available on the financial market. In view of their importance, we will mainly focus on credits and venture capital as they still represent the big bulk of all SME financing (Grant Thornton, 2002). Other instruments to promote the use of leasing, factoring or credit insurance might however complement a loan or venture capital policy. Moreover, one

should bear in mind that most policy focusing on access to finance is mainly trying to increase the supply of capital. As argued above, these policies can only be efficient if combined with policies that seek to move towards the demand side of the market trying to stimulate entrepreneurship and the creation of enterprises. Therefore we will firstly deal briefly with some actions focusing on the demand side that should go along with a supply-oriented policy.

Demand side actions

Different economic studies show that markets, including financial markets, can never work efficiently as there is always an information gap (Manigart, 2001). Although the problem of information asymmetry as such can never be completely solved, different techniques can create a better mutual understanding between the different partners. Different ways of increasing knowledge and awareness amongst entrepreneurs, bankers, business angels and public authorities must be explored. In order to illustrate our proposals we will look at three different actions focusing mainly on demand issues: the investor readiness, the mutual understanding between bankers and SMEs and finally the integrated finance approach.

Investor readiness

There is evidence that entrepreneurs hold back from seeking external finance as they are unsure about the practicalities and worried about the complications (DTI, 2001). The only way to cope with this investor readiness gap is by accurate information towards enterprises. Indeed, entrepreneurs, especially those running enterprises with growth potential and who are willing to grow, need greater understanding of venture capital and specialist advice on how to structure business plans to secure external equity finance. An empirical study carried out in Australia confirmed that by ensuring that new ventures are investor-ready the business-investor community can avoid a substantial waste of money (Douglas, 2002).

Financial institutions should help in filling this information gap in terms of what is available and under what terms and conditions. This investor-readiness gap does not only apply to equity capital but is relevant to all forms of finance. Going to a business angel with a story written as a pitch to a public sector development agency is the quickest way to be shown the exit door. Therefore part of what needs to be done is to bring entrepreneurs to a point where they recognise how to tell the right story to the right investor at the right time. The regions and localities can create an investor-readiness climate through case studies and setting up platforms where potential investees and investors can meet.

Mutual understanding between bankers and SMEs[3]

Relations between bankers and SMEs are mainly a matter of perception. Mutual trust is a key element in facilitating access to finance. In order to contribute to achieving this objective, banks and SME organisations should work closely together. The picture of relationships between banks and SMEs is very complex, especially in a market that is constantly being reshaped. Banks are confronted with scarce resources relative to human resources, information technology and capital. New trends in corporate governance are leading in practice to further pressure from shareholders looking for value for the shareholders in ever more competitive markets. Mergers and acquisitions are becoming daily business. And last but not least, SMEs are becoming less loyal to banks. Indeed, SMEs are also confronted with a more competitive context in a globalising market. Structural changes within the company, new information technology and rapid innovation are enabling SMEs to take a leading role in the Schumpeterian process of destructive creation. The financial sector is also affected by this, by the market-imposed search for the most economic way of functioning. SME relationships with bankers are hence no longer based only on an interpersonal belief in the banker but are also determined by the kind of products and the related costs that banks offer them. Therefore relations between banks and SMEs are mainly determined by profitability considerations. Banks will only develop or further develop an SME policy if it can be integrated into the overall objectives of the financial institutions and be quantified in profitability. SMEs, assisted by many financial experts, will look for the most advantageous solutions to their financing problem. Conflicting interests between banks and SME organisations hence lurk behind any corner.

In order to improve relations between banks and SMEs, therefore, the setting up of round tables could be envisaged. These tables, involving high level representatives from banks and from SME organisations aim to identify the main problems in the bank/SME relationship and try to highlight a range of best practices. This could lead to the establishment of a code of conduct. Such a code of conduct can be done in a general way at European level. Each region should organise round tables and try to establish such a code.

The subjects that could be dealt with concern venture capital and links with the banking sector, efficiency of public guarantee schemes, transfer of enterprises, micro-loans, ratings of SMEs, reorganisation of banks, bank

3 . List of topics mainly taken from the European Third Round Table for Bankers and SMEs, 2002 (available *on www.europa.eu.int*).

attitudes towards Basle II and so on. Topics that could be discussed and possibly be covered in a code of conduct are, for instance:

- Does an SME have specific needs and should specific products therefore be developed?

- Are SMEs very heterogeneous and should one perhaps consider high-risk SMEs, women entrepreneurs and young entrepreneurs differently?

- The role of account managers. Customer relationship skills are considered the main factor differentiating the service offered by the different financial institutions. In this context one of the major elements is to determine what skills are required and whether special training should be foreseen.

- The problem of financing the transmission of enterprises, within the family or to third partners. Business angels are rarely interested in this financing and venture capitalists are only focused on large-scale management buy-outs. Questions raised concern the matching of buyers and sellers, the financing of goodwill, and the way in which due diligence can be organised cost-effectively.

- How will virtual and electronic banking change partnerships?

- Do SMEs expect bankers to play a role in providing additional support to SMEs?

- How can one create more transparency in the decision-making process and ensure more accurate information on reasons for refusal of financing to SMEs? Bankers in contact with SMEs should be able to explain why a certain request was rejected and why the bank proposed another solution.

Integrated finance approach

The integrated finance approach aims on the one hand to determine the needs and the nature of the financing of the business at the various stages of its development and on the other, to ensure that from the outset the various potential providers of capital (development agencies, bankers, leasing companies, business angels, venture capitalists, etc.) are involved in the determination of the funding necessary. It is a concept that aims to reduce the

cost of finance for SMEs by pro-actively analysing the likely finance needs in the performance of a business plan or project. It seeks to achieve conditional offers from different finance providers against performance milestones. A venture capitalist can therefore commit himself in principle to an investment at a given point in a company's development. This, in turn, may offer comfort to a business angel who is asked to provide early stage capital. Further analysis of expenditure needs may identify requirements in principle for invoice discounting or asset finance at other stages of development.

This pro-active financial modelling concept has a number of advantages:

- It demonstrates a command of financial requirements
- It secures all the elements of appropriate finance in one exercise
- It should reduce cost by removing elements of uncertainty
- It presents a strong image of the company, thus enhancing its prestige

Implementing such an intelligent and analytical approach to funding SMEs is extremely difficult to achieve. So far it has not happened. Banks and other finance providers want to protect their margins and their so-called "one-stop finance" is often a misuse of the term. A proper diagnosis of financial needs by product is beneficial but a key element of integrated finance thinking is competition between providers.

Many banks and finance providers already offer a complete range of products but offer them as a basket of services to customers in which some components may not be competitively priced. Hidden tariffs such as these increase costs, undermine sustainability and adversely affect cash flow.

Companies and entrepreneurs can only successfully exploit the potential of integrated finance if they are robustly prepared. A number of interventions have already been tried. One of the most successful has been the *fit4finance* assessment panels designed and delivered by Business Link Hertfordshire in England. Companies present their funding opportunity to a number of active finance providers including bankers, venture capitalists, grant providers and business angels.

This panel-based "trial by expert" is extremely effective in helping businesses and entrepreneurs to assess internal barriers to their access to finance, but also very powerful in releasing competition between the financiers. This movement towards a more intelligent approach to SME financing is only

just beginning to gather momentum but promises to unblock many barriers preventing SMEs from fully achieving their growth potential.

Concluding remarks on the demand side

The different concepts explained in relation to the demand side -investor readiness, mutual understanding through round tables, and the integrated finance approach – are in my view three concepts that should be promoted by city and region governments. Implementing the three measures simultaneously can create synergy. In Walloon for instance, they are included in the action plan for entrepreneurship and developed by the local public finance agency (see *www.4x4entreprendre.be*).

Supply side actions

Actions on the demand side are more focused on perception and information but actions on supply-side are more heterogeneous. We will analyse five different ways of stimulating the supply of finances: the stimulation of credits; the increase of venture capital through the use of guarantees, the increase of supply of venture capital involvement in venture capital funds, the stimulation of business angel investment and finally the involvement of big companies.

Credits

Sometimes it is considered old-fashioned to discuss guarantees and credits. However, given that most companies, and especially starting companies, are not capable of furnishing the necessary guarantees, and in view of the above-mentioned developments (concentration phenomenon, Basle rules and higher yields) most economists consider that there is an increased rationale for government intervention. Financial instruments, other than mortgages, that can provide guarantees to banks, have been developed enabling SMEs to obtain loans on the right terms for the prevailing market conditions. One such instrument is the loan guarantee scheme.

A *Loan Guarantee Scheme* is a scheme providing guarantees to banks lending to SMEs. Such guarantees range from 30% to 80% of the loan value. The schemes can be organised (and funded) by governments and thus through public funds: so-called *Government Loan Guarantee schemes*. They can be set up on national (France and the United Kingdom for example) or regional

(Belgium and Germany) level. The government provides a guarantee to the bank against a premium paid by the borrowing party to the bank or government. This third party, coming between banks and their clients, provides a guarantee of last resort. The justification for spending, or even losing, public money is that, through guarantee schemes, viable SME projects will be financed by loans, thus creating employment and contributing to economic growth; in other words, assisting in the creation of additional economic wealth.

In contrast, another type of scheme, the *Mutual Guarantee Scheme* (MGS), involves private groupings of companies, often linked to sector-specific interest groups, to provide loan insurance to the banks. The philosophy behind the mutual guarantee scheme is that closer links between the interest groups in SME-dominated industries, namely, crafts and commerce, can result in a better knowledge by the banks of a company's standing, and of the markets in which it operates. Prior selection of members helps to increase the credibility of the group, because the MGS knows the enterprises that apply. This in turn allows a better *ex ante* evaluation of the project by the lender. Credit risk is thereby considerably reduced. The fact that the mutual guarantee organisations trust the enterprises and their projects, and express this trust by offering the lending bank a partial guarantee, makes it easier for the latter to grant loans. In a certain sense, guarantees offered by the mutual system are not merely financial in character, but also technical and moral, since through the operation of the system banks become familiar with the technical and moral capacities of the borrowing firms. If such schemes are well implemented and designed, additional bank lending may also be considered, and the costs of such lending controlled. Thus, through the medium of "solidarity" (mutual cooperation), SMEs are able to obtain better access to loans and to loans under better terms.

Although the advantages of professionally-managed mutual guarantee schemes seem evident, in practice it is often much easier to put public money in a public fund than to stimulate the setting up of an MGS. There is therefore some legitimacy in sophisticated policy intervention, complementing a policy option, which, at present, is mostly just a matter of funds. Stimulating the setting up and development of MGS requires a more thoughtful approach where government needs to play a more "arm's length" role (Cressy, 2000). The leverage effect of a public guarantees fund counter-guaranteeing a mutual guarantee fund is likely to be much higher that in the case of a direct public guarantee approach.

At world level, 70% of guarantee systems are government-based, with 25% private-sector-organised and 5 % co-operative-based (Dovan and Livitsky, 1997). In the European region we can see that loan guarantee schemes differ. Mainly countries from Northern Europe, such as the United Kingdom, Ireland,

Finland and the Netherlands are active in the field of public guarantee schemes, but the system also exists in Greece, and though Belgium and, to an even greater extent France, rely on a mutual guarantee system; they also have a public guarantee scheme. Mutual guarantee systems are well developed in Belgium, France, Italy, Portugal, Spain, Finland and Sweden. Austria and Germany have a bank-based system close to the mutual system. Most of the public guarantee schemes are implemented at national level, while most of the mutual guarantee schemes are implemented at regional or local level. Perhaps one of the most cost-effective ways to implement guarantee schemes is by setting up local or regional mutual guarantee schemes, which are counter guaranteed by public schemes at national and/or European level.

Nevertheless, if the guarantee system is public, mutual, or mutual but publicly backed, in order to be efficient five criteria have to be fulfilled (Aernoudt, 2002):

- The procedure for request and approval should be automatic at bankers' level. This means that no separate request should be sent from the intermediate bank to the guarantee system. A framework agreement should clarify the relations between the bank and the guarantee scheme, setting out the modalities to be applied to each individual project. Such a framework can be set up at regional or local level.
- Linked to this element, legal certainty should prevail at the level of the financial institution, making involvement of a discretionary external decision authority superfluous. Banks would inform their customers immediately about the credit decision, knowing that they can in turn appeal to the guarantee scheme, provided that a number of conditions are fulfilled. In Germany and the Netherlands for instance, the bank knows that they can draw from the public guarantees in an automatic way as long as the amount of the guarantee request does not exceed 50% of the credit granted to the company. For the remaining 50%, banks can appeal to traditional guarantees, such as mortgages or pledges, or grant the credit without supplementary guarantees.
- Customers can have direct contact only with the financial institutions. All contact with the guarantee scheme runs through the intermediating bank. Guarantee schemes must not be, or be perceived to be, captive (meaning being linked to one bank).
- Securitisation must be foreseen and obtaining the public guarantee should have an impact on the reserve obligation of the portfolio at

bankers' level. Pursuant to Basle II, such modalities already exist in Germany and in the United States.

- Special attention should be given to those parts of the market where market failure is the most obvious, such as starters, involving a higher coverage rate or even grace periods.

Guarantees as a tool to promote venture capital

Another way to use guarantees is as a tool to promote venture capital. Different approaches are possible. The two main ways are guaranteeing investments from the venture capital funds in companies and guaranteeing investors in funds. While the first approach is the most commonly used in Europe, the second approach is utilised in the United States. An alternative way is allowing private investors a fiscal deduction of eventual losses like for instance the system in the Netherlands. Let us consider the three methods in more detail.

Guaranteeing venture capital investments in companies

The first method is currently used in seven out of the fifteen member states of the European Union, most on national level. The others do not currently have a scheme guaranteeing risk capital. Let us have a brief look at some examples. In Belgium, enterprise policy is a matter for the regions and the Flemish government has launched an initiative based on a similar experience in the Netherlands in the 1980s (abolished as it was considered too expensive). In order to facilitate SMEs' access to venture capital, investments are guaranteed (the guarantee percentage increases over time from 30% in the first year, to 40% the second year and to 50% thereafter). The regulation was adopted in 1997 and, as the results were rather poor, the Government intends to replace it by a fiscal incentive scheme on risk capital investments within the context of the recently obtained regional fiscal autonomy. The French authorities focus mainly on participation in seed capital funds with an overall guarantee policy for risk capital. The BDPME (Banque du Development des PME) in France also guarantees venture capital in a similar way to the Belgium system but the guarantee level can be up to 70%. The system is developed at national level but the implementation can vary from one region to another based on agreements signed between the region and the BDPME. The European Investment Fund (EIF) was mandated by the Council of the European Union to explore innovative ways of providing guarantees to venture capital funds and the legal basis was foreseen within the multi-annual programme for enterprise and entrepreneurship for the period 2000-2005.

Guaranteeing investors in funds

A second method is guaranteeing the fund-raising side of the venture capital fund. This is another way of pushing private investors into the risky business of start-ups, by guaranteeing totally or partially any potential losses on their investment. For an example on how this can be done efficiently, we can look to the American SBIC measure. The SBIC (Small Business Investment Company) programme, which was launched in 1958, underwent a major reform in 1992. It aims to increase the availability of long-term equity and loan financing for SMEs. The SBIC programme is the main (indeed the only) programme of support for venture capital at US federal level. At regional level it is rather the fiscal instrument that is used, in combination with the federal SBIC, to promote investments in risk capital.

The basic advantage of the system is “leverage”. In SBIC jargon, this means the funding which SBICs can raise on public capital markets by using the SBA (Small Business Authority) guarantee or by selling securities directly to the SBA. To obtain leverage, regular SBICs sell debentures (debt securities) or participating (equity-type) securities guaranteed by the SBA. In the case of SBA-guaranteed debentures, pools are formed, and SBA-guaranteed participation certificates are sold to investors through a public offering. An SBIC may leverage up to 300% of its private capital. In addition, an SBIC with at least 50% of its “total funds available for investment” invested or committed in “venture capital” may receive an additional tier of leverage per dollar of private capital for total leverage of 400% of private capital. However, in no case may any SBIC draw down leverage in excess of $90 million. The SBA never buys SBIC securities itself – it only guarantees them. The SBICs can raise capital through debts or (since the reform of 1992) by issuing "participating securities". We can summarise the two possibilities as follows:

Based on the figures 1999-2000, for every 1$ appropriated, around $200 is invested and the public cost for a job creation is around $500. The SBA also believes that the net cost to the taxpayer of the SBIC programme (taking account of increased tax revenues etc.) is negative, i.e. the programme pays for itself. Although the system is implemented at the federal level, one could easily imagine the implementation at regional level. In Belgium for instance, both the Flemish and the Walloon region have decided to implement an SBIC-inspired system.

Table 4.5. **Debt versus quasi-capital**

	Debenture Leverage	**Participating Securities**
Min cap SBIC	$5 million	$10 million
Fundraising SBIC:		
Leverage	3 to 1	2 to 1
Interest Payments	Semi-annual	Prioritised payments
Rate	Treasury 10 year +	Treasury 10 year +
Profit Shares	No	9-12%
Investment Policy	SMEs having ability to service debt	SMEs looking for investment

Guaranteeing private investors in companies

A third way is by "guaranteeing" private investors that they can deduct eventual losses from their taxable revenues. This approach is very well developed in the Netherlands. As this new scheme, replacing the previous (real) guarantee system, is mainly intended to provide an incentive for people who want to invest directly in related companies, it was called Aunt Agaath, as in an aunt investing in her nephew's or niece's company. Private individuals are indeed often a neglected source of financing. Most of these individuals have money, but neither the time nor the interest to get involved in entrepreneurial activities. Rather, they are looking for the best placement for their money, and not for the best investment. On the risk-return level they often prefer a lower return if it is compensated by a no-risk level. The risky business of start-up financing is not for them, unless the risk is taken by someone else, or if the starter is a relative. But even in this case a fiscal incentive might help.

The Aunt Agaath measure ("Tante Agaath regeling"), implemented since 1996 in the Netherlands, facilitates investment by private individuals in companies set up by family or friends. This method of financing – often called in literature the three F's, referring to friends, fools and family – seems to be the most frequently used for financing the initial expenses of setting up a company. In order to push more people to do this, the Dutch government decided to grant fiscal incentives to the investors granting subordinated loans (meaning that in case of liquidation all other loans are paid back before the subordinated loan is paid back) to start-ups. They involve tax-free interest of up to 2 500 euro a year per investor. Furthermore, the investor is allowed to deduct 2 500 euro from his fiscal revenues in the case of a loss on the investment or a non-payback agreement. This reduces almost by half, depending on the marginal income tax, the amount that can be lost in case of failure.

An evaluation of the programme showed that starting companies could obtain easier access to finance thanks to the Aunt Agaath rule and that the lending conditions were much cheaper than normal market conditions. It was estimated that around 10% of Dutch SMEs benefit from the system. From this example, it is evident that governments should play a role in stimulating investments, especially direct investments, in start-ups. Although one could argue that in most countries taxation is not a regional competence, the setting up of a Tante Agaath inspired system is very interesting form the point of view of local development policy, as most of the investments financed through this system are proximity investments.

Venture capital actions: money as an incentive

Beside the guarantee instrument, can one imagine more direct intervention in the venture capital market? Until recently, policy-makers were relatively absent from venture capital markets. The usual subsidy schemes did not seem to be compatible with the venture capital business, and, moreover, it was felt that there was no shortage of capital in Europe. On the basis of this last argument, venture capitalists tended to agree with policy-makers that no government involvement was needed in the field of venture capital. What was lacking, they said, was not capital but good projects and these could only come from creative individuals, not from public bodies. Recently, on various occasions (e.g. Lisbon Council, 2001), policy-makers have stressed the importance of venture capital as one of the main tools for economic growth and job creation. This evolution in political and economic thinking has been translated into a number of concrete actions in the field of venture capital.

The financial context described above is not a sufficient reason to legitimate any form of government involvement. Indeed, the fact that the market fails does not mean that government does it better. Public schemes must therefore avoid ruling out market systems but should try to influence them in order to reduce the number of market failures. In the field of financing, with particular reference to the equity gap, the government could try to improve the functioning of the market by trying to increase the confidence of financial institutions, banks and risk capital societies in enterprises.

Confidence is, however, based on perception and is very difficult to change. To this end, city and region governments and development agencies must try to launch projects through the market in order to change the risk-averse mentality. This can be done, for instance, by stimulating the financing and setting up of venture capital funds. Action should be focused on those market niches that are not covered due to high risk and low profitability. Government

measures are therefore mainly useful in fields such as seed and start-up risk capital as the market does not reward investors for the additional risk they take. In order to be efficient, such incentives must be market-oriented. Therefore, direct financing of activities with government involvement does not mean that public money is used to set up venture capital funds that compete with funds working with own financial resources. Financial intervention means that public money will be invested in existing, well-managed funds which want to (re) direct their activities towards those niches which are not covered as long as investments are based on short-term expected returns. In regions, especially less favoured regions, public money can be used to set up new operations in collaboration with the private sector. Therein lies the tricky element of government intervention, as one can never be totally sure that the investment would not take place without government involvement. Any action must, therefore, be very clearly focused in order to avoid cannibalism or free-riders. Regular external evaluation and reorientation of public action is therefore required.

From the point of view of the efficiency of public spending, it is fair to say that the multiplier effect of participation in venture capital funds may be higher than is the case for lost subsidies, as the participation triggers private money. A midway, and perhaps very subtle, solution is for public money to co-finance, during the starting years, through a grant or reimbursable advance, the operating costs of newly established venture capital funds which focus their activities on clearly defined areas. Further analysis is needed to measure the efficiency of these two kinds of intervention, or of their optimal combination.

In addition to the direct financing of the setting up and/or development of venture capital funds by capital participation or contribution to overheads, government action can be directed towards better stimulation of the general conditions for access to finance. This may involve actions aiming at a better functioning of secondary markets, assuring exits for venture capitalists, training for fund managers and, what seems more difficult, projects aiming at changing cultural attitudes to finance.

Let me illustrate the different means of government intervention. Rather than taking a theoretical approach, I have chosen to focus on real examples. We will first focus on direct financial support measures for venture capital, secondly analyse the uses of guarantees as a tool to promote venture capital and lastly make some final remarks on the different venture capital schemes. Since the early 1990s most countries in Europe have set up mechanisms to facilitate access to venture capital for innovative firms at an early stage. Different techniques have been used such as setting up own funds, co-investing with

private investors, investing in privately managed funds or financing the working cost of venture capital funds. I will analyse these four means of intervention.

Setting up own funds

The first approach was used in Belgium. The *Investment Company for Flanders* (GIMV), established in 1980, pioneered the concept of government-funded venture capital run by independent private management. GIMV investments, which are primarily equity stakes in technology-based companies, are concentrated in the Flemish region of Belgium. The two other regions of Belgium (Brussels-Capital and Wallonia) also have regional government-funded venture capital funds. These two funds are *Société Régionale d'Investissement de Bruxelles* (SRIB) in the Brussels region and *Société Régionale d'Investissement de Walloon* (SRIW) in the French-speaking region. Empirical evidence showed that the growth of companies, having been backed through these public regional funds, was higher than private venture capital backed companies (Manigart, 2002).

Co-investing with private investors

The setting up of public funds leverages little private money. Moreover, direct public involvement is often considered by the market to be unfair competition. Therefore, it seems more appropriate to leave the decision to the private sector and let the public agencies act as co-investors. A good example of this approach is the German one. The Technologie-Beteiligungs-Gesellschaft (TBG – Technology Investment Company), a subsidiary of the government bank Deutsche Ausgleichsbank (DtA) runs a *co-investment scheme.* It passively invests a matching amount of up to half a million euro alongside a venture capitalist. This national run scheme could easily be implemented at regional level.

Investing in privately managed funds

A third approach is to invest in funds, rather than in companies. This fund-of-funds approach leaves the individual investment decision to the fund manager. Since in most cases it is foreseen that the public involvement cannot exceed a certain percentage, it leverages private money. As I consider this approach to be efficient from the point of view of leverage, I will give a number of examples to illustrate how it can be implemented.

In the United Kingdom, the Department of Trade and Industry focuses on amounts of between £50 000 and £250 000 as it considers this "small equity gap" as a market failure in an overall market with sufficient financial resources (DTI, 1999). As a measure to address this gap, Regional Venture Capital Funds have been set up and the UK High Technology Fund, which invests in different specialised funds, has raised over 200 million euro, coming mainly from the private sector. The government contributes around 30% of the capital.

In the Netherlands, the *national* government has created hybrid venture capital companies, most having a regional coverage. The funds are known as each with PMTSs *(Participation Companies for New Technology-Based Firm*s), a minimum capital of 5 million euro. Of this amount, approximately 1 million euro is provided by the government as quasi-grant loans; the balance comes from banks, third parties, and, to a lesser degree, from regional development companies (the government provides about half of the RDC's own funding). A government loan to a PMTS has a five or seven-year term, but if at maturity the PMTS has invested most of its capital in new technology-based firms and has reinvested any income received, the government will convert the loan to a grant.

In 1994 Finland established a 100% state-owned venture capital fund, *Suomen Teollisuussijoitus Oy* (TESI – Finnish Industry Investment), to be primarily funded by proceeds realised from the privatisation of state-owned companies. TESI operates as a *fund-of-fund*s, i.e. it invests in venture capital funds, which must have a majority private ownership. A fund-of funds approach, rather than a single direct investment vehicle, was chosen to ensure significant stage and risk diversification and to allow some realisations to be made within a relatively short time-frame. The funding of TESI is around 100 million euro. Part of the TESI capital can be provided by the private sector, although the state plans to maintain majority ownership in the venture capital funds in which TESI invests.

In addition to TESI, Finland has a network of regional venture capital funds run by SITRA (Finnish National Fund for Research and Development) and *Kera Ltd*., both of which are publicly owned. Both SITRA and Kera limit themselves to minority positions in the regional funds. SITRA, active in venture capital since the 1980s, concentrates on technology investments. Finland's Kera is attached to the Ministry of Trade and Industry and its main activity is risk financing and SME development. Its venture capital fund, the *Start Fund of Kera Oy* (SFK) emphasises early-stage technology company investing. In 2001, Greece set up its fund-of-funds, mainly targeting New Technology Based Firms. In Paris a regional fund of funds was established.

As can be seen from these different examples, most of the funds of funds are at national level. This is mainly due to the fact that a sufficient scale is required. Beneficiary funds however are often regionally based.

The approach of investing in funds has been retained at European level as well. Capital support from the European budget can be provided by three different institutions: the European Investment Bank, the European Investment Fund and the European Commission. Participation by the European Commission for instance can take place either through regional policy (through the structural funds), or through enterprise policy (within the multi-annual programme for enterprise and entrepreneurship 2000-2005 through the ETF (European Technology Facility). It is important to note that investments are realised in conformity with the *pari passu* clause which means that an ETF start-up investment will always be on the same terms as, and rank at the same level as, other private equity investors. From this explanation one can deduce that the main goal of the ETF start-up facility is to act as a catalyst in the market by channelling private funds to those niches of the market that are not sufficiently covered by the market. Evidence of support from other investors, especially from the private sector, and of the extent to which the ETF start-up investment can be expected to have a catalytic effect are two of the selection criteria. The scheme can be complementary to regional or national schemes. Beneficiaries are often regional, but rather important, funds.

Financing the working cost of venture capital schemes

A fourth way of encouraging the provision of risk capital at seed stage is by covering a part of the working cost of a fund. The reasoning behind this is that seed money is highly labour-intensive. Due diligence for instance, is as expensive for seed investments as for big deals and so venture capital managers cannot afford to deliver a due diligence for seed investments which generally concern relatively small amounts. Targeting the management cost constraint is therefore considered to be a means of encouraging the formation of additional private-sector commercial early stage funds. In order to cope with this "small equity gap" the greater proportional cost for the analysis of seed investments, estimated at 2 to 3% of the seed investments, could be partly paid by public funds. This was the reasoning behind the European Commission programme CREA (Capital Risque pour les Entreprises d'Amorçage), that ran from 1998 to 2001 and contributed up to 500 000 euro towards operating costs of newly set up funds, to support them in the initial phase when they have almost no revenues from exits. Most of the funds that received financing for their working costs were acting on a regional or transregional level. A first evaluation

estimated the public cost per job at around 2 000 euro, which is much below the classical subsidy schemes (Bannock, 1998).

A similar programme has been adopted within the multi-annual programme for Enterprise and Entrepreneurship 2001-2005. This program foresees a grant of 100 000 euro for each junior manger recruited by a fund and is managed, on behalf of the Commission, by the European Investment Fund (EIF). The principle can, in my view, easily be applied at regional level.

Business Angel Networks: tool par excellence for regional development

The same reasoning led various countries to support the functioning of the business angel networks. One of the best ways to bridge the information gap between business angels and entrepreneurs is by setting up business angel networks. Business angels are often former entrepreneurs, who – after having sold their company – want to invest in start-up companies and provide advice based on their own business experience. The business angel networks form a platform where SMEs and business angels can make contact. This platform can function through the Internet, magazines or organising fora. The networks would give SMEs access to a new source of finance alongside bank financing and venture capital.

Business angels are very interesting for regional development, as empirical evidence shows that most business angels have a strong preference for investing in companies located close to where they live and work (within 100 miles or two hours travelling time). This is for two reasons. First, because of their other commitments business angels are reluctant to spend time travelling to distant locations to investigate investment opportunities. Second, because business angels play an active role in the companies in which they invest they do not want to spend time travelling long distances (Mason, 2002).

As business angels are very different in their attitudes and functioning from formal investors, it does not make sense to try to extrapolate policy measures used to stimulate the use of venture capital to business angels (Aernoudt, 1999a). Stimulation of the use of informal capital in order to facilitate access to funds or money for enterprises needs a different approach. It must be clear that business angels do not need money. The fact that they have money makes them business angels. Their own capital, often the result of a successful sale, covers the availability of money. Besides, the part of their capital that they make available for informal investments covers only a limited part of their assets.

The main obstacle to the development of informal investment, apart from the crucial fiscal and regulative environment, is rather the lack of good, and well-presented, projects. If there is any market failure, it is on the investors' side and hence, in how to find (not select) the potential projects. Experiences in the United Kingdom and in the Netherlands showed that this market failure can easily be remedied by very simple means. On the one hand, investors have to be guided in the presentation, both written and oral, of their projects, and on the other hand, they have to be brought into contact with business angels who might be interested in their projects. Concerning direct aid, only very small amounts are needed in order to finance the functioning of the business angel networks.

A first attempt to make a cost-benefit analysis of government involvement estimated the public cost for job creation through the stimulation of business angels at 800 euro/job (EBAN, 1998). This is 3 to 4 times less than public actions in the field of formal venture capital but around 30 times less than the traditional grant schemes. In Belgium, a working group under the responsibility of the federal Minister of Finance concluded that a yearly amount of 60 000 euro should be allocated, by the responsible regional authorities, to each of the different Business Angel Networks (BANs). In Germany, the Government set up BAND (Business Angel Netzwerk Deutschland) in order to create and support different regional networks. Over 40 networks have been created in a two-year period. The European Commission took the same approach when it launched its call for proposals aimed at stimulating the development of the informal investment market, which led to the financing of different networks in Europe and the creation of EBAN, the European Business Angel Network (Aernoudt, 1999b).

Involvement of large companies

Beside venture capital funds and business angels, a third important source for equity finance is the big companies. Indeed management skills and financing are abundant in most large companies. As shown by the above-mentioned surveys, this is exactly what start-ups and SMEs are most lacking. A precondition for considering large companies as the ideal partner for financing SMEs and as the stimulus for regional economies is the extent of their own entrepreneurial orientation (Lumpkin, 2002). This embraces five dimensions, namely innovativeness, pro-activeness, competitive aggressiveness, risk-taking and autonomy. Fostering entrepreneurial orientation in large corporations might have a significant impact on the regional economy, directly by its impact on their own performance, and indirectly by its enhanced support for SMEs. Let me give some examples of possible involvement of large companies in this area.

Large companies should help to fill the small equity gap. We should look for innovative ways to involve large companies in this stage of financing by stimulating them to participate actively in seed funds and by involving their executives in business angel activity. Indeed, most of the executives do themselves fulfil all the characteristics of a business angel but only a few really systematically invest in starting companies. Perhaps we should find better ways of converting these virgin angels into active informal investors.

Beyond the direct impact of smart money, corporate ventures could co-invest with seed funds, especially in sectors that have a link with the corporate investor. Already today corporate investors represent around 6% of the annual equity raised in the venture capital market, but there may be innovative ways of trying to stimulate large companies to invest in second-round financing, rather than investing in an MBO-dominated market. This can only be achieved by converting corporate investors into smart money investors, including hands-on management, rather than leaving them in their role as "followers" of the leading venture capitalist. Recent market evolutions might help this conversion. Making large companies more entrepreneurial and translating this into appropriate financing for SMEs should be the real objective of corporate venturing. From a point of view of regional development, often corporates do invest locally as part of their corporate social responsibility. In Walloon for instance, a study has been launched in order to determine the best way to use these corporates as tools for local development.

Making large companies more entrepreneurial should, at the same time, be one of the best ways of involving them in the supply of premises, not as sponsors but as partners. The private sector tends to undersupply premises for SMEs given that rents are higher for retail and residential uses. Thus the public sector often gets involved in part-financing business incubators, science parks, office parks or industrial estates. Incubators have indeed developed very quickly in Europe but have been largely integrated into a non-profit culture. Their aim is to contribute to regional or local development (Aernoudt, 2003). These first-generation incubators still have a role to play but, in addition, real incubators should hatch primarily fast-growing companies, which ensure the most added value and jobs. Incubators focused on spin-offs are, in this sense, crucial. Large companies could easily be involved in the financing of both structures as the traditional incubators might offer a low-risk low-return approach whilst spin-off incubators might fit into their new entrepreneurial orientation.

Recommendations linked to local implementation

Rather than focusing on short-term subsidy policies, adding funds to an abundant market, one should analyse how city and region governments and development agencies can act as a catalyst in order to stimulate the private sector to bridge the different gaps identified, such as the risk capital gap, the equity gap, the confidence gap and the investment readiness gap. Any region should, in this context, determine the optimal debt-equity hybrid financing instruments.

In relation to guarantee schemes a number of pitfalls must be avoided in order to avoid the negative selection argument, meaning that only the weakest projects are presented to the mutual or public government scheme. Especially at regional and local level mutual guarantee schemes should be considered, eventually counter backed by national or European public guarantee schemes.

In relation to venture capital funds, from the point of view of the efficiency of public spending, it is fair to say that the leverage effect of participation in venture capital funds and loan guarantee schemes may be higher than is the case for subsidies. A midway and perhaps very subtle solution is for public money to co-finance, during the starting years, through a grant or reimbursable advance, the operating costs of newly-established venture capital funds or business angel networks. Further analysis is needed to measure the effectiveness of these two kinds of intervention, or of their optimal combination. Furthermore, the potential of business angels should be stimulated through regional business angel networks and corporates should be motivated to contribute resolving the financing problem.

From the previous analysis, some general conclusions can be drawn about how cities and regions can maximise private leverage:

- The most successful schemes are operated by professional financial services managers, and not by officials of public administrations.

- Research must be carried out on the actual needs of SMEs, on the potential of private investors and on the deficiencies of the existing products on offer in the regions before launching new schemes.

- Performance targets must be set in order to measure the impact of the aid in relation to the regional and local objectives.

- Private sector participation is not only essential in terms of input of additional finance, but the expertise that it brings also helps to ensure the sustainability of projects.

- In relation to venture capital funds, there is a need for a clearly defined exit mechanism for investments.

In this context, supply-side driven policy should go hand-in-hand with demand-side policy in order to increase its efficiency. Actions in the field of stimulating investment-readiness, creating mutual understanding between banks and SMEs, and, last but not least, promoting the integrated finance approach will undoubtedly enhance the leverage and create more value for public money and at the same time more value for private money.

On implementation it could be useful to set up a one stop shop that would be responsible for the different policies at regional or local level. Allow me to end with a concrete example. In the Walloon region of Belgium, SOWALFIN (Société wallone pour le financement) was set up (operational since September 2002). This umbrella organisation has a total of over 900 million euro for financing SMEs with a priority to start-ups (for a region with 3.5 million inhabitants). It functions as a one-stop shop for entrepreneurs offering different financial instruments such as guarantees, subordinated loans and risk capital investments. In a first phase it regrouped all existing local investment funds and existing guarantee schemes. In a second phase, SOWALFIN will also function as the financial vehicle that will develop new financial products such as the implementation of the SBIC-formula in order to create leverage to public funding, as well as a guarantee scheme for micro-credits. Besides, SOWALFIN will be the instrument that will develop the demand-side instruments such as the integrated finance approach, the round table with bankers and SMEs and the investor readiness. All of these instruments are integrated in the regional action plan for entrepreneurship.

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CHAPTER 5
SMALL- AND MEDIUM-SIZED ENTERPRISES: CONSTRAINTS AND POSSIBILITIES IN LONDON

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This chapter concentrates on the practical experience of London in seeking to leverage commercial funds into small firm support policies for access to finance, provision of good quality accommodation and micro business development.

The remarks in this chapter are largely based on practical experience of the implementation of public policy on economic development in London, but it is hoped that they will have a general resonance for economic developers seeking to devise and refine tools to achieve their objectives anywhere. The chapter will concentrate on the policy issues surrounding the support of small and medium sized enterprises (SMEs) as the main generators of new jobs, rather than the big infrastructure projects where a distinct set of issues regarding the involvement of commercial funding applies.

At the most basic level, the importance of attracting private sector funding to facilitate the aims of public policy rests on the experience that the amount of public funding available is always going to be constrained, particularly in relation to the scale of problems to be addressed. In terms of political priorities, helping small firms is simply never going to rank significantly against the main spending demands on government. In any case, thinking of private finance as a substitute for what might ideally be provided from the public purse is unhelpful in relation to small business support policy. Rather, the attraction of private finance should be a key aspect of effective SME support policy, irrespective of how much public funding might be available.

Why should this be? It is simply that small firms are private sector creatures, operating within commercial markets both to generate their revenues and to secure the goods and services, which they require to trade. These markets will not always operate in such a way that the objectives of public policy, to maximise the performance of SMEs, are realised (the phenomenon of so-called "market failure"). But this chapter will argue that government intervention is most likely to be effective and sustainable for the long term if it involves working with the grain of the market, finding commercial solutions, which involve commercial finance where this is needed. Continuing subsidies, and the dependency they foster, are dead-end approaches.

The potential for leverage in London was highlighted in "London's Leverage", a report prepared by the London Development Partnership by Greater London Enterprise and the Corporation of London in 2000. Recognising that the relatively prosperous London region could not look to more public spending for its regeneration solutions, the report recommended a strategy for enhanced leverage of commercial funds to be coordinated by the new London Development Agency, which was in the process of being set up as the report was published. Particular priority was placed on the leverage of private investment into small, growing businesses; social enterprise and community economic development; industrial estates specialising in SME accommodation; town centre retail improvements; and local regeneration partnerships.

In the period since "London's Leverage" appeared considerable progress has been made, particularly in the area of SME support. There is a new Regional Venture Capital Fund of £50 million with over half the cash coming form commercial sources, there has been a rationalisation and increase of funding for micro businesses, again with leverage of bank and business angel funding as the key drivers.

There are three main areas of policy which tend to concern government in support of SMEs:

- improving small firms' access to cash: this may include creating new sources of finance, as well as helping firms to better access cash from existing funders. This area of policy covers addressing the needs of a wide range of different types of businesses: high-growth, maybe high tech, equity-seekers to relatively low growth firms where appropriate loan finance is the issue.

- providing good quality, affordable and suitable accommodation for growing small businesses: in urban areas this may be linked to regeneration issues such as finding uses for brown-field sites.

- creating and supporting micro businesses: again this category ranges from the firm with high growth potential, to helping disadvantaged groups in society to become more economically active.

In that commercial markets leave deficiencies in outcomes in these areas of policy, which worry economic developers, there are constraints on business growth to be addressed.

Access to finance

Because public policy inevitably concentrates attention on the problems, it is important to bear in mind that, for the most part, commercial markets actually work extremely effectively in delivering financial services to SMEs. Apart from the obvious basic banking services, an array of more specialist services including term loans, factoring and invoice financing, leasing, and venture capital are offered by firms which compete vigorously with each other for clients. But of course all markets work imperfectly, and at the margins, many SMEs, by virtue of their size, their sector, their location, the ethnicity of their management, or the skill limitations of their management, find it harder to access the services on offer, and this may constrain their growth. The description "at the margins" does not indicate any lack of importance, but

simply that those firms affected are experiencing special circumstances which set them apart from the mainstream. This means that to be effective, the public policy response should be targeted at the special circumstances, both in their scale and precision.

It is also important for policy makers to be aware that if financial services are denied by a competitive commercial sector, there must be powerful market forces at work which make this so. This reinforces the argument for the policy responses to be well researched, focused and fit for purpose.

This approach produces a paradox in policy development, in that it suggests the need for an extensive range of diverse, well-targeted programmes. The complaint in London is always that there are too many SME support programmes leading to client confusion and to duplication of both services and of delivery costs. This arises because many of the programmes are similar and either fail to focus on particular niche market needs or are poorly promoted. Policy responses may also fail to focus appropriately by being too big, thereby creating an over-provision of funding for the perceived objective of the public sector intervention. It is probably too early to level this criticism at the new Regional Venture Capital Funds in England, but there must be a danger that these large funds (£50 million in London) will struggle to find enough deals of the required quality, bearing in mind that the Fund's focus on small deals requires a maximum first investment size of no more than £250K.

The use of loan guarantee schemes by government also has the potential to increase the amount of commercial funding levered into SME support, and such measures have the merit that they operate to reinforce the workings of the market. The Small Firms Loan Guarantee Scheme has operated for many years in the United Kingdom, giving the commercial banks government backed security on loans to SMEs, soon to be 75% for loans up to £250K. These schemes can work well if their operation is user-friendly for the banks, and experience in the United Kingdom has not been good in this respect. They have the great advantage of being demand-led, and have the potential to complement other support programmes to improve the “investment readiness” of SMEs.

At the regional level, there are now indications in London that public policy aimed at improving SME access to finance is getting smarter, and is doing so through programmes which lever in substantial private sector cash. Models of small loan funds based on public or charitable funding which then gear up using a subordinated bank loan are increasingly common. A number of agencies have established portfolio management track records with high risk small businesses which enable the banks to be confident of their lending to the sector. There are innovative programmes levering in business angel investment alongside public

funds with further gearing with bank lending. The Regional Venture Capital Funds are themselves successful examples of leverage, with the London fund receiving 30% of its funding from the UK Government, 18% from the European Investment Fund and 52% from wholly commercial institutional investors.

Box 5.1. **OneLondon's London Seed Capital Fund: £2.7 million of government funding levers minimum of £2.7 million business angel funding into early stage businesses**

*One*London is the not-for-profit subsidiary of Greater London Enterprise. Its business angels network consists of over 120 high net worth investors. Its average deal size is about £75K and it completes about ten deals a year. During 2001 it attracted £2.4 million of investment funding from the UK Government's Small Business Service to be invested alongside the angels, with the angels having to commit to at least half the equity requirement of any deal, thus creating an investment capacity for the Fund of at least £4.8 million. This means that the average deal size can double using the same volume of angel funding. With the addition of loan from the government's Small Firms Loan Guarantee Scheme, finance packages of £250K are possible, directly addressing the “equity gap" problem faced by firms seeking smaller amounts of investment to finance their growth. Sponsorship from a range of financial intermediaries, intensive marketing and support from an investment readiness programme helps to maintain a strong deal flow for the Fund.

There is also an increasing understanding that publicly supported funding initiatives must be focused and well promoted in order to be effective and to attract sufficient deal flow. Equity and loan schemes specifically to assist start-up and early stage businesses in high-tech, especially in association with universities, the creative sector, and niche manufacturing, are of growing importance and most have close links with the private sector, either through direct, levered funding or sponsorship, or through the levering in of other resources such as mentoring.

It would be unthinkable now for a new funding initiative to be launched in London without a heavy private sector involvement. This trend has an impact beyond the leverage of cash and other resources. It is also reflected in patterns of the governance of funding programmes, with representatives from the commercial sector being fully included in the process. In the medium term this will bring the individuals and firms involved increasingly into a policy development role with public sector agencies.

Public policy to improve SMEs’ access to finance in London is increasingly concerning itself with helping firms to reach existing sources of both private and public sector cash more effectively, rather than attempting to

increase the supply of suitable funding. The success of such measures to improve "investment readiness" offers clear benefits to commercial suppliers of financial services, including the banks and many intermediary firms. As a result, active support for the programmes in terms of participation of personnel and of sponsorship is being levered in from the commercial sector, greatly boosting the impact of the resources being committed by the public sector.

Provision of good quality accommodation

Whilst London may provide a vigorous market place for successful, growing businesses, we know that in many other respects London can be a hostile environment for small firms. In particular, good quality, affordable commercial accommodation is in short supply. This may force a business out into London's doughnut beyond the M25 motorway, or even farther afield, or it might simply constrain the growth of the business. None of these are good results for economic development in the London region, where jobs are needed in the inner city.

Competition from other uses such as housing often drives up land prices, which would result in rent levels for commercial property that SMEs could not pay. On this basis, commercial funds are inhibited from entering the market and are attracted to invest in land uses, which offer better returns. This should be a circumstance in which public sector involvement could be important, perhaps deploying some of the large land holdings in public ownership, much of it brownfield and vacant. Making such sites available, at price levels which would facilitate a viable development at prevailing commercial market rents, should create the conditions in which substantial private sector funding might be levered in, increasing the supply of accommodation. This is a difficult area for local authorities because the financial regimes under which they work discourage the disposal of assets such as real estate at below market rates. Imaginative deal structures, such as tendered joint ventures may alleviate this problem, but a change in the policy approach of central government would also assist the process greatly.

This broad-brush analysis of the problem and the leverage solution, whilst valid, does not tell the full story. The fact is that good quality SME accommodation can be profitably supplied by entrepreneurial, niche property firms. Greater London Enterprise, the development company owned by London's local authorities, has a strong track record of successful commercial property development in London. The Workspace Group, which specialises in SME accommodation across a number of sectors, sold its provincial portfolio during 2002 in order to concentrate its resources on London and the South East of England. This experience indicates that if developers and landlords take an

entrepreneurial approach themselves, treating SME requirements as a niche market, and understanding that market well, with its own planning and other regulatory regimes, working with key partners like the local authorities, and understanding how to access the development subsidies already available, it is possible for them to bring substantial amounts of commercial funds into play.

Box 5.2. **Availability of EU Objective 2 Funding facilitates the provision of affordable good quality accommodation for SMEs in London's most deprived neighbourhoods**

The use of Objective 2 funding to lever commercial funding into the development of good quality accommodation in London has generally involved a commercial real estate developer working with a local authority. Objective 2 funding is only available in the poorest areas of the region. Market rental levels in such areas are too low to provide a return to a commercial developer, giving little prospect for improved facilities. A combination of appropriately priced land from the local authority, with the grant funding under Objective 2 can bring down the capital cost of a scheme such that the level of rents which local firms will pay provides a sufficient return to attract commercial funds to finance the building. Both Greater London Enterprise and Workspace plc have financed projects on this basis in recent years. The problems have included excessive bureaucracy and the long period of time that it can take to put such a deal together. This means that only developers with experience of dealing with the public sector are likely to be attracted by the opportunity, limiting the potential scope for leverage.

It is clearly important that public policy should seek to reinforce these trends if it is to maximise the leverage of commercial funds into commercial property development and attract more firms into the market. These are some of the points which the public sector, and particularly local authorities, needs to address:

- it needs to develop an ability to work to a commercial sector timetable where opportunity cost is a vital element in making developments happen,

- it needs to be pro-active in marketing existing subsidy regimes to potential developers,

- it needs to be pro-active in making sites available, and ensuring that the use of planning and the rest of the regulatory regime works in a business friendly way, and;

- leadership – political and institutional – needs to be exercised such that all the public sector agencies with an impact on site availability

work well together to give a high and equal priority to creating more good quality SME accommodation.

The opportunities for increasing leverage into commercial property development and refurbishment are already clear from existing practice. A much more entrepreneurial response is required from the public sector if this leverage is to be maximised.

An effective public sector response would have a much wider impact than simply levering more finance into commercial property. The heightened sensitivity to the accommodation needs of SMEs should make a positive contribution to an effective regional business retention strategy.

Micro business support

This chapter has already discussed the way in which small loan funds may be structured to lever in substantial amounts of bank finance, in addition to a commitment of funds from the public sector, despite the high risk/low return profile of unsecured lending to very small businesses.

This model can be applied to all types and sectors of micro enterprise, but the main thrust of public policy in London so far as micro lending is concerned, has been towards the assistance of excluded social groups to provide new opportunities for economic activity, or to increase the number of jobs available to them. Micro firms with significant growth prospects require equity investment. Venture capital firms specialising in early stage high tech investments serve this market, and the public sector in the form of central government has made funds available through initiatives like the University Challenge Fund. So far there are few examples of leverage to create mixed public and private sector vehicles, except perhaps through the operation of the Regional Venture Funds which may allocate a portion of their funds to this specialised area of investment. The combination of very high risk and very high return potential make it technically difficult to use the leverage models which have been shown to work where anticipated outcomes are less extreme.

However, this problem can be tackled by government encouragement of private sector investment in start-up/early stage investment through the use of targeted tax breaks. In the United Kingdom, an initial 20% tax rebate is available on the initial investment, and no capital gains tax is payable if the investment is held for three years. As with loan guarantee schemes, this type of leverage works with the grain of the market and is demand-led.

At the social end of micro enterprise support policy, the anticipated introduction of tax credits to encourage an increase in the flow of private sector funds into deprived areas in the United Kingdom has the potential to increase levels of leverage. This will depend on the ability Community Development Financial Institutions (CDFIs) have to devise vehicles that are attractive to commercial funds from corporate or personal sources. As noted above in the section of the chapter dealing with access to finance, this will involve creating niche offerings for which CDFIs are able generate strong and appropriate deal flow.

A further critical issue in maximising leverage for micro enterprise support is the need to sustain the existence of good quality fund managers, to raise funds, to manage the lending and to support the portfolio of enterprises, which have received funding. This invariably needs some form of public subsidy to pay for the overhead costs of such fund managers, a point that is often ignored by policy makers on the assumption that a payment of some percentage of funds under management will be sufficient. It almost never is, and there are often problems in diverting cash from scarce funds which have a social purpose to pay for their own running costs.

Box 5.3. **OneLondon's London Business Growth Fund (LBGF): bank finance levered into micro loan programme tacking social exclusion**

In its present form this scheme has been operating for two years in partnership with HSBC Bank and the Corporation of London. Unsecured loans are made to micro businesses of between £1K and £20K, where it has been demonstrated that the funds cannot be raised through conventional means. Marketing of the Fund is targeted towards excluded groups through appropriate intermediaries. *One*London places a cash deposit with the bank against which the bank grants a facility of four times that amount for lending on to the micro businesses. Bad debts are shared equally between the bank, the City Corporation and *One*London, with *One*London's liability being limited to the amount of its deposit with the bank. It is a condition of all loans that the recipients work with a business mentor, experience having shown that this greatly reduces bad debt ratios. The provision of mentors is financed through other business support programmes. In the last two years lending has totalled £575K, with bad debts representing less than 3%. The LBGF operates as a revolving fund, maximising the use of the available cash. Although the partners' primary objective is non-commercial, the Fund is run on a strictly business-like manner, both to minimise costs and losses and to help clients develop a credible lending history for the future.

Some guiding points on maximising leverage

Practical experience in London over a number of years suggests a number of key requirements if the leverage of commercial funds into economic development projects is to be maximised and sustained. If levered funds are to become a well-established part of funding mechanisms, the vehicles used have to be seen to deliver the outcomes upon which the funds were obtained. This creates a common interest with policy-makers, therefore, to a considerable extent, some of what follows has a general application as good practice in economic development.

– *public policy should introduce mechanisms which go with the grain of the market when addressing so-called "market failure"*

This means working with the market and attempting to achieve improvements on the margins of established market mechanisms, rather than attempting major engineering to change market behaviour. This means having a close understanding of how the market works, and of the particular needs of target client groups. It means finding ways to work with existing suppliers of services and intermediaries to help deliver the desired public policy objectives. When considering the leverage agenda, these factors apply equally to working with funders as well as recipients.

– *give absolute priority to deal flow*

All too often the public policy assumption is that if a fund or some other service is established to redress a market failure, SMEs will beat a path to the door of the delivery agency. In practice such a flow of clients rarely appears so easily. Indeed, wholly commercial mainstream venture capital companies have to devote considerable resource to market their services to ensure a sufficiency of the type and the quality of deals they require for investment. Public programmes need effective marketing even more.

Detailed research to make certain that programmes are designed to meet the market need, followed by sophisticated, targeted promotion during the implementation phase, are both needed to get this right. Programmes which lack deal flow undermine the credibility of intervention policies and where leverage has been achieved this will make things much more difficult for future attempts.

– *treat all funders and potential recipients as clients*

This may seem an obvious point when the task is to raise funds, and all the emphasis is on persuading the funder to release the cash. It is not so clear in dealing with potential recipients, but it is essential if quality deal flow is to be generated and maintained, and satisfactory investment or loans made.

– *consider all economic development programmes as a series of niche opportunities, rather than as a means of "solving" the big problems. Success in economic development is all about making progress at the margins.*

This point is a continuation of the previous items. Ensuring precision in the objective will mean taking a niche approach, and addressing a niche market should result in fit-for-purpose implementation if the preparation has been done properly. There is a multiplicity of niches within the SME sector, and specialist tools are needed to tackle each of them where perceived market failure is inhibiting the realisation of a public policy objective.

– *achieving successful leverage is a commercial activity, which demands an entrepreneurial approach by economic developers, as well as organisational structures to encourage and facilitate this.*

This is a particularly difficult area for economic developers working in the public sector, which works to a set of norms, which are very different from the commercial sector, where leveraged funds are going to come from. Issues of taking risks, of management independence, of corporate governance, of methods and priorities of working in the public sector, of central government regulation – including issues such as EU state aid rules – are all things are often at huge variance with the requirements of commerce. Waiting for the next committee meeting for a decision with an uncertain outcome, or enduring the interminable waits involved in an over-bureaucratic funding application process can be the delays which kill off desirable leverage deals.

Since the publication of the report *London's Leverage* by the London Development Partnership in July 2000, which was financed by Greater London Enterprise and the Corporation of London, and examined the scope for increasing private investment in London's communities and businesses, the economic development community in London has been making progress in adopting the mechanisms to increase the volume of leverage. There is still a long way to go before anything like the potential is realised. London is particularly well placed to pioneer this aspect of economic development bearing in mind the size and sophistication of its financial services sector. In a Europe

where regional funding from the European Commission is likely to be severely restricted beyond 2006, policies that reduce dependence on public funding, and make what public funding is available work harder, will become much more important. Progress in London could provide useful experience here and will merit close monitoring over the next few years.

CHAPTER 6
BROWNFIELD REDEVELOPMENT: STRATEGIES AND APPROACHES IN EUROPE AND THE UNITED STATES

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This chapter highlights trends in European and US-American strategies towards attraction of private investment for brownfield redevelopment, and provides examples of ways in which municipalities may work with, and benefit from, programmes within a regulatory framework offering specific tools and incentives for private investment on brownfield sites.

Introduction

The revitalisation of brownfields is closely tied to the model of "sustainable urban development". Brownfield sites are not necessarily contaminated, but they are areas of land which have previously been used for development or which are located within existing urban centres. Site reclamation, a way of providing developable space and nature zones without consuming more land, is e.g. in Germany defined as the "use-related reintegration of real estate which has lost its previous function, such as closed industrial plants, military installations, transport facilities and small business premises, into the economic and natural system by means of planning, environmental and economic policies" (North Rhine-Westphalia Ministry of the Environment, Regional Planning and Agriculture, 1992).

According to the European CLARINET Working Group on "Brownfields and Redevelopment of Urban Areas", brownfields are sites that:

- have been affected by the former uses of the site and surrounding land;
- are derelict or underused;
- have real or perceived contamination problems;
- are mainly in developed urban areas;
- require intervention to bring them back to beneficial use (CLARINET, 2001).

Hardly any other policy currently matches brownfield revitalisation in the way it combines the three components of sustainability: the *ecological* component through the prevention of additional consumption of space, the *economic* component through the encouragement of investment in inner city sites; the *social* component through the combination of revitalisation projects with job creation and skills upgrading programmes, and through fostering residents' sense of social and historical identification (as exemplified by the industrial park projects of the International Building Exhibition – IBA – Emscher Park in the German state of North-Rhine Westphalia). This sustainable touch makes brownfield redevelopment a hot topic not only in Europe and the United States, but also appears as a major political challenge to reduce land consumption and revitalise urban areas in many OECD countries.

This chapter will highlight the trends in European and US-American strategies towards the attraction of more private investment for brownfield redevelopment, as well as providing examples of ways in which municipalities may work with and benefit from programmes within a regulatory framework, which offers specific tools and incentives for private investment on brownfields.

Trends towards leveraging private finance for brownfield redevelopment in Europe and the United States

Programmatic changes in Europe

As a result of the massive decline in the coal, steel and textile industries at the beginning of the 1980s, comprehensive strategies and programmes of brownfield revitalisation were developed, particularly in the United Kingdom, France (especially in Lorraine and Nord-Pas de Calais), Germany (especially North Rhine-Westphalia) and Belgium. Due to the dominance of coal and steel industries in traditional industrial regions, sites were often very large, with a low land value and high rehabilitation and decontamination costs. Here, government intervention was indispensable as it could not be expected that the private sector and property market itself would solve the problem. Consequently, since the beginning of the 1980s in the United Kingdom, France and Germany, initiatives have been developed which favour specific brownfield programmes. These initiatives were triggered, on the one hand by increasing awareness of the negative economic and ecological effects of the derelict sites, and on the other, by recognition of the positive development potential of such sites. Regional, national and European funding was provided to finance these programmes, and projects have effectively been paid for by the taxpayer.

Today most cities and regions in Europe are facing brownfield problems. Characterised by a dynamic land market, industrial uses dating back to the 19th century are subject to a persisting displacement pressure and have often moved to peripheral areas as part of the urban sprawl process. Together with the existing large-scale railway and port infrastructure facilities, such urban areas are subject to an ongoing pressure for re-use, reinforced by speculative land banking. The interest, use and ownership conflicts resulting from such a situation can lead to a large extent of derelict land in urban areas. The strategies used by cities and regions to bring derelict land back into use mainly focus on using the classical instruments of urban planning. Large-scale projects are developed by architectural competitions, master plans and investor planning. Problems that particularly concern brownfields, including land for building, infrastructure and contaminated soil, are often inadequately considered and can lead to considerable friction and losses or even complete project failure. Less attractive brownfields in peripheral locations, therefore, are often insufficiently developed. Intermediate uses and derelict areas have become a serious problem for urban development in the areas concerned.

Brownfields have been identified as a key obstacle to private investment, even if they also represent an important economic development potential, albeit

one which is difficult to mobilise. Funding has therefore been concentrated on impetus providing initiatives in order to initiate private investment. The different conditions prevalent in different types of areas require different strategies and programmes towards private investment to support redevelopment:

- In Northern France, brownfields were quickly removed to restore an attractive outer appearance to the region and thus attract private investors not just to the abandoned brownfield areas themselves, but also to newly developed "Greenfield" sites in the concerned areas.

- In the Ruhr area of Germany, ecological transformation has been very successful. In the Ruhr, brownfield problems have been remedied by combining ecological necessities with economic objectives e.g. by developing ecological business parks. The aim is to develop environmentally friendly industries and regenerate areas for re-use by new industries. Examples for this approach are the redeveloped areas of the "Zeche Waltrop" or the "Zeche Sachsen" in Hamm – both also located in the German state Northrhine-Westphalia – which were turned into business parks and deliberately integrated into green spaces. In addition to that, high ecological standards and innovative techniques (e.g. energy and water saving, waste reduction, ecological building materials) have been realised on these sites.

- In the United Kingdom, traditional objectives of economic promotion to attract private sector investments – establishment of business and industrial parks, job creation – have been at the centre of policy supported by the central Government. Funding has been focused on the renewal of inner city industrial sites, preferably by industrial re-use with private or public-private initiatives.

There are signs that these changes will be supported more strongly on the political level: The Commission intends to focus on the integration of soil protection objectives in other policies. As a first step, the Commission published a paper in April 2002 "*Towards a Thematic Strategy for Soil Protection*" pointing out that pressure on land and soil is still growing, in particular by soil sealing and land take by urban expansion. Importantly, the European Environmental Agency (EEA) stressed the need for targeting development on brownfield sites while maintaining and enhancing areas of green space. The discussion of sustainable land management considers brownfield sites as an issue of major importance. Also at the European level, it is increasingly recognised and documented that the presence of unused

brownfield land has various negative effects not only on the environment, but also on the economic and social health of a city (see OECD, 1998).

The need for PPP and leveraging private investment

Across Europe, the public sector, often experiencing fiscal constraints, is not able to solve major redevelopment tasks alone. Against the general current background of dramatic budgetary deficits at the federal, state and particularly municipal government levels, public-private partnership approaches and strategies of leveraging private finance to clean up abandoned sites and revitalise inner city areas become more and more important.

A change in the real estate policies of major private landowners in the 1990s contributed to a further increase in brownfields. In Germany, for example, the largest railroad, energy and communication corporations are growing active to sell considerable amounts of land as part of their business operations. A further increase in disused space can be expected in the future. In the light of lower levels of utilisation of office space (workplaces in homes, teleworking, etc.) and of shrinking service sectors (for instance in banks' customer consulting and post offices) one has begun to speak of "service-sector brownfields". Moreover, in the not too distant future, considerable idle commercial capacity is expected to appear outside of cities, above all in eastern Germany (Kahnert and Rudowsky, 1999, p. 153). This trend will lead to an oversupply of abandoned sites, particularly in the new German states (for an overview on current activities, obstacles and approaches of site recycling in German city practice cf. Tomerius and Preuß, 2001). In this configuration, issues of local site management and strategies of public-private partnerships (PPP), particularly in terms of leveraging private finance, become make-or-break determinants of site recycling and brownfield redevelopment.

A growing number of developers see brownfield redevelopment as a business of "modern" urban development offering economic chances in business niches. Matching the need of the public sector for private financial support some developers have changed from the still widespread understanding of brownfields as a complicated, risky business to a more open attitude seeing redevelopment as a business opportunity, particularly in attractive inner city areas. In the meantime an increasing number of developers understand remediation costs and contamination risks as being just one part of the professional risk and cost management to be handled in PPPs, often representing only a small percentage of the overall project costs.

Several European and national funding programmes are available for the rehabilitation of brownfield sites. But currently a severe budget crisis in many cities has lead to a growing need of leveraging private money for brownfield redevelopment. In economically poor European regions municipalities struggle hard or are not able any more to bring in their financial co-funding necessary to get access to national or European funding programmes. Also because of weakened administrative capacities the need for cooperation with private expertise and the need to leverage private money for brownfield projects is significantly growing.

Programmatic focus to attract private investment in the United States

According to a survey by the United States Conference of Mayors (USCM) there are more than 21 000 brownfield sites alone in the 232 cities taking part in the survey (United States Conference of Mayors, 2000, p. 9). The total number of known brownfield sites in the United States is estimated at 400 000. Thus site availability for redevelopment is high. According to the Urban Land Institute (ULI) in Washington DC, some cities assume that their supply of abandoned land could satisfy development demand for about 150 years.

Most large polluted sites are owned by private businesses. They are often left abandoned because of the risk of liability and the subsequent costs of remediation (risk assessment, clean up costs). Often the cities cannot solve these problems alone. The states or the federal government must help to tackle them with redevelopment funding programmes.

Ironically, where brownfield sites have been redeveloped, this has often been done without public money. However, this only concerns those sites that are profitable to redevelop. There are many others, which under current policies will never be reclaimed because they are too polluted and/or situated unfavourably. In between are the sites where public money can help and incentives do matter. Therefore the US approach and particularly the latest brownfield legislation passed in 2001 very much focuses on leveraging private finance. This has been one of the main aims of these policies, particularly through the use of specific economic tools such as tax and financial incentives for private investors on brownfield sites (for more information, see Section 4).

Project categories for public and private sector leverage

The redevelopment of urban brownfields can involve many different private organisations, including transport companies, investors, developers,

landowners, etc. These parties will obviously have very different interests in relation to the redevelopment of the site, and the way they participate in the process will also vary. Private companies look at a project in terms of profitability and market potential. If the private sector is to be brought into a project, it is therefore important that the costs are reduced or that there are ways in which the return can be improved. In discussing the different forms of leveraging private investment into brownfield projects, it is useful to sort projects, not only according to former use, but also according to:

- The economic profitability of the project, including costs for site preparation (with remediation costs).

- Location, real and potential land value and demands for its further use.

Both are closely connected to the legal and planning situation as well as the technical infrastructure (e.g. water supply, sewage, and traffic connection). Using these criteria in the context of property value and reclamation cost the sites can be classified into three types (Ferber, 1997). The following categorisation proved to be helpful in focusing on efforts to leverage private investment for brownfields [also EU networks like CLARINET or the new "Concerted Action on Brownfield Economic Regeneration Network (CABERNET) work with these categories]. City practice is challenged to sort out projects where PPP approaches are in need and thus focus on site potentials likely to be developed with public and private finance approaches.

a) "Self-Developing Sites"

   These are sites with their own dynamic for development. The redevelopment causes a clear increase in site value. There is no demand for special public intervention. The regular planning and administration system provides a satisfactory framework for the development.

b) "Potential Development Sites"

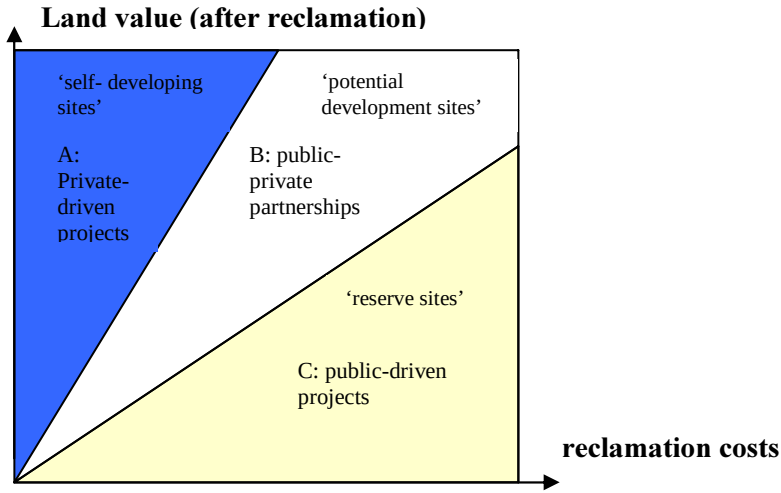
   These are sites of local or regional importance with development potential but also significant risks due to the final balance of the investment (i.e. regarding the aim to realise a profitable project in the end) and the need for advice and assistance in planning and funding. These typical brownfield projects are situated in the border zone of profit and loss. In such cases strategies of public-private partnership are most effective. Risk-division, co-ordinated planning and the

financing of projects by public/private companies are innovative instruments for public intervention.

c) "Reserved Sites"

These are sites without development potential for the next few years and are the most problematic sites e.g. traditional industrial regions. A high density of brownfield sites in a certain area and low site values together with high preparation costs do not permit a dynamic of self-development. These sites will not be regenerated without public intervention.

Figure 6.1. **Categories of brownfield sites by extent of public participation**



A-Type: private-driven projects

The redevelopment of brownfield sites in type "A" projects is largely private-sector led. A very significant proportion of projects take place with very little direct involvement from public bodies and government agencies, except in their roles as "regulators", issuing and enforcing necessary approvals and legal permissions (such as town and country planning).

European systems of "town and country planning" could promote this type of brownfield redevelopment largely by inhibiting or preventing development projects on greenfield sites, and by making brownfield land available for development. The public authorities should show confidence in a project, for example by creating a climate that includes other partners like housing

associations to invest in targeted neighbourhoods. Nevertheless private developers should be able to initiate, prepare and to realise such projects in an integrative urban, economic and technical approach, i.e. combining and harmonising planning and remediation requirements according to the intended reuse in a balanced cost- and time-effective proceeding.

A good example is the redevelopment of the 14-hectare OKAL site, a former wood processing plant in Titisee-Neustadt in the German region of Baden-Württemberg. Despite the attractive location, the site had been derelict for 12 years, mainly because of contamination of groundwater and soils. Due to the failure of former development projects the local authorities started a fairly intensive dialogue between the private developer, planning and environmental authorities and future users of the site. In this iterative process, the project benefits were proved to all the partners. So even without direct public funding, sufficient project benefit came from granting of permission for housing and commercial uses on the site. Formal agreements have been fixed in a public-private contract. The private developer:

- acquired the site
- prepared the demolition, remediation and redevelopment plans
- co-ordinated planning permission procedures in close cooperation with the local authorities
- provided funding with private capital
- was responsible for the marketing.

As a result, 60% of the area has been developed for housing and 40% for commercial space. This brownfield site has now been revitalised as an attractive area of a small sized town by using private competence and investments. The public sector played simply a facilitating role.

B-Type: public-private partnerships

Successful private investment in this type of project depends on a very narrow analysis of risks in the redevelopment process. Close cooperation between the landowner, the developer and the local authority is a precondition. When the public sector co-operates with the private sector on a redevelopment project, all stakeholders involved can bring their own interests, creativity and knowledge to create a realistic and financially sound development which can count on the support of both public and private parties. These public-private

partnerships are becoming increasingly common, and the various stages of the development process are often regulated through agreements, contracts and covenants. In many locations, brownfield redevelopment is eligible for direct public sector financial support, necessary to achieve social and economic policy objectives. This support can appear in a number of different forms, such as:

- Grant aid, either for particular elements of the costs of development or as "gap funding" (i.e. to bridge the "economical gap" with funding money in order to make the project profitable).

- Support for loans, including payment of interest and guarantees.

- Other guarantees, e.g. income stream guarantees, support for right for first refusal of the site.

- Partnership projects with risk and profit sharing.

For example in the United Kingdom, direct funding is generally provided by national government through arm's length public sector regeneration agencies – including English Partnerships and the network of Regional Development Agencies in England; the Welsh Development Agency; and Scottish Enterprise. In some cases, the funding is provided through the channel of local authorities, either directly from national government or via the national or regional regeneration agencies. In addition to these national sources of funding, other projects receive support through Objectives 1 and 2 of the European Structural Funds (principally the European Regional Development Fund) and through Community Initiatives (such as URBAN II). Private investment often sees these supports as decisive steps forward to project realisation because financial risks are lowered and profitability gaps are bridged.

Recently, legal problems have been identified with many of the national funding programmes, as the European Commission has identified them as "governmental subsidies" and contrary to EU competition policy. This places strict limits on the geographical availability of financial support for private sector development, and also on the amount of support for any individual project. Other indirect financial tools have been used in the past, such as tax breaks in designated "Enterprise Zones", again an important incentive approach to attract private investment.

One of the European laboratories for PPP models is the London Docklands area, which has seen very extensive brownfield redevelopment (see Figure 6.2). Since the early 1980s, several models have been tested. Today a large partnership approach between local authorities, the national government and the private land

owners in the wider Thames Gateway area is in practice. One central goal is the redevelopment of brownfields for housing (Thames Gateway Partnership, 2002).

Another prominent example is the Maastricht Ceramics site (Zandvoort, 1998). The Ceramics site is situated at the edge of downtown Maastricht. Since the middle of the last century this site of some 23 hectares had been the centre of the ceramics industry. Until 1990 it was used by the company NV Koninklijke Sphinx. However, the last remaining divisions of this company relocated to other sites in the city in 1990.The area forms an important link between the districts of Wyck and Randwyck. Since the advent of the ceramics industry, this site had been isolated from the rest of the city by high perimeter walls. For this and other reasons the site formed a physical barrier separating the outlying areas behind it and the old centre. The development of the site will restore the relationship between these two areas. This is one of the reasons why the municipality of Maastricht has, for some time, been interested in the Ceramics site. Plans to buy it up and develop it came to nothing because of the high price of the land, which the municipality could not afford on its own.

Figure 6.2. **A public-private partnership opportunity: Brownfield Redevelopment in the Thames Gateway, UK**



On 10 June 1987 Sphinx gave the municipality the opportunity to purchase the entire site. This time purchase could go ahead with the help of the ABP pension fund. Right from the outset ABP indicated that it wished to be involved in the project, based on the shared objective of a high-quality development of the site. ABP therefore concluded contracts, in the consultation with the municipality, with three property developers.

The building plans included the following:

- 1 600 homes,
- 70 000 m² (gross floor area) of offices and other establishments;
- 20 000 m² of hotel accommodation,
- 20 000 m² for cultural and other non-commercial purposes,
- 5 000 m² for catering and retail use,
- 4 400 parking spaces (the majority underground/covered).

In addition to that a number of supra-local facilities are being built, such as a bridge over the river Maas for pedestrians and cyclists, a market hall and various traffic access schemes. Work started on the plans in late 1991. After more than ten years the project is now completed.

The Netherlands Ministry of Housing, Spatial Planning and the Environment designated the project as a model for public-private partnerships (PPP), with the aim of fostering the development of public-private partnerships for urban regeneration projects.

The formula chosen for the development and realisation of the project was one of public-private partnership between ABP and the municipality of Maastrich. The main features of this partnership are as follows:

- acquisition of the necessary land and premises;
- agreements relating to the legal aspects of the project;
- establishment of the financial framework for the exploitation of the site;
- laying the necessary building site infrastructure;

- execution of the construction work;
- agreements on the apportionment of risks and responsibilities.

The agreement on cooperation was amended in 1994 by means of a protocol, which dealt with matters such as the planning, scheduling, development and realisation of the various project modules and quality. The amendment was designed to ensure that the buildings were realised within the desired quality specification, and resulted in a substantial acceleration in the rate of progress. The development of the land is regulated by a land-use plan, adopted at the end of 1989 and approved by the province of Limburg in June 1990. The land-use plan incorporates a certain flexibility in order to allow for economic and social developments, which may occur at any time during the process. The entire project cost NLG 900 million (ca. 408.5 million euro). The land was acquired by ABP, which will be responsible for financing the exploitation of the building site. The municipality of Maastricht has initially contributed NLG 19 million (ca. 8.6 million euro) towards the realisation of the project. A further NLG 50 million (ca. 22.7 million euro) will be forthcoming for the construction of the library/ municipal buildings. The financial risks associated with the Ceramics project are being shared by two parties. The precise basis on which the risks are apportioned was specified in the 1994 protocol to the original agreement. The Ceramics project is acting as a national demonstration project in relation to:

- partnership with private enterprise;
- its innovative approach to a large construction project;
- the high quality of the homes, offices and infrastructure;
- the fast-track planning process, based on a long-term vision and long term agreement;
- the intermixing of different functions.

Opting for a simplified procedure and short ways of decision-making between all stakeholders included in the project produced good results. The factors that appeared to be decisive in ensuring rapid decision-making were that parties were properly mandated and that good contacts were maintained between the parties involved.

Figure 6.3. **Successful public-private partnership for redevelopment of the Maastricht Ceramics Site, Netherlands**



A striking example of a successful cooperative approach in financing a brownfield project is the "Duisburg Inner Harbour" project in Germany, State of Northrhine-Westphalia. Covering an area of 900.000 square feet and extending to one mile length, the formerly grain and timber trading harbour started its revitalisation on the basis of a masterplan having qualified in an internationally announced planning competition in 1991. The development and marketing concept was closely linked to the International Building Exhibition in the Ruhr area in 1993. Close cooperation was established between the city and the newly founded Inner Harbour Development Company (IDE). The mixed-use concept required considerable public pre-investments for a restoration of an old city wall, a harbour bridge, a marina, three museums (for civic and cultural history, for modern art and for children), for a "grachten-canal and housing concept" and for a "garden of remembrance". These public fundings qualified the area and thus worked as strategic incentives for private follow-up investments, e.g. in the form of the revitalisation of old warehouses and an old factory now offering space for offices and service enterprises. In the course of these encouraging developments, new buildings were also erected and are today home for tourist corporations, further offices and a police service unit. The attractive

mixed-use concept includes high quality housing along the water (canals/"grachten") and a new Jewish community centre.

Apart from qualifying the area through an innovative mixed-use approach for private follow-up investments, the city opted for a specific finance strategy: the city of Duisburg transferred the property to the IDE development corporation. Thus exploitation benefits could be strategically used by IDE for further step-by-step project developments. Public money from the city was effectively combined with different funding sources from European, federal and state governmental programmes (apart from classical structural funding programmes also historic preservation and job qualification funding programmes). As the site was located in a designated redevelopment area according to the "German Urban Development Support Act" tax relief in the form of a 10-years/10% depreciation of the investment could be offered for the investor. And as redevelopment integrated the preservation of historical buildings, further tax incentives could be made available. Different funding projects were defined within one project in order to be able to use different funding sources for one perfect in most flexible ways.

Though public pre-investment added up to ca. 60 million euro, the turn towards a mainly private follow-up investment was achieved in 1997. In 2003, where about 80 % of the whole project is realised, the whole amount of private investment is estimated at 250 million euro. According to the Urban Development Agency of the city of Duisburg, one calculates with private investment of altogether ca. 350 million euro when the inner harbour-project is finalised.

C-Type: public-driven projects

For many projects in traditional industrial regions, private sector for brownfield redevelopment is not available. The strategic approach in these cases is focused on a long term and regional perspective. A successful model initiative can be seen in the regional brownfield management approach in Lorraine, France, which provided funding for development in the context of the national "contact de plan". Altogether, 3 350 hectares of derelict industrial land had to be treated between 1987 and 1998. As it was clear from the beginning that it would not be possible to immediately find new uses, the strategy developed in 1986 concentrated on the rapid improvement of the ecological situation through large-scale landscape treatment. Preparation of the land for new uses, which involves much higher costs, is a medium and long-term task. Therefore, all efforts were focused on overcoming the negative image of the

region's development sites caused by brownfields. The programme priorities were based on:

- the first, and simple priority of rapid identification of derelict land;
- the establishment of a regional development agency;
- a clear and comprehensive methodology – "requalification sommaire";
- adequate and regular funding from national, regional and local budgets;
- a partnership of all parties involved (mainly all public authorities and private landowners);
- support for the preparation and development of derelict land for the implementation of leading projects with regard to the development of the region.

"Ordinary redevelopment" ("requalification sommaire") is clearly preferred if any after-use project can be found. This derelict land strategy contains:

- demolition as well as clearing work in the area;
- construction of terraces and planting, enclosing or the planting of screening trees;
- construction of recreational paths;
- where necessary, treatment of contamination using all legal instruments to make the polluter pay.

Subsequently, the properties are managed on a regional level and, in individual cases, left to the free property market. The executive body of this part of the programme is the regional development agency, the "Etablissement Public Foncier de la Metropôle Lorraine"(EPML). EPML has been entrusted with the implementation of this strategy.

The strategy chosen was exemplary as it succeeded in linking the interests of the private property owners, the community and other actors in the framework of a co-ordinated regional master strategy. The regional stakeholders

are co-operating in a common network with research activities (e.g. land evaluation methods and models; technical soil encapsulation; interim use concepts) and international services for EU accession states.

Leveraging private finance for brownfield redevelopment in the United States: instruments at federal, state and local level

Given that the public sector in the United States also faces severe budget restrictions, the question of how to attract more private investment ranks high – if not in first place – in the discussion on brownfield redevelopment. Considerable efforts have been made to leverage private finance into approaches to revitalise abandoned sites in US cities. This applies at all levels of government. Thus a number of federal, state and local government programmes have been launched with the aim of improving prevailing conditions for PPP and private investments in brownfields. As a rule public funding money may not be given to private investors directly. Therefore regularly the municipalities are the "matchmakers", the connecting links, to make public funding from federal or state programmes available for PPP and private investment projects. The following chapters will highlight US Federal and State programs and their targeted instruments, which may be used by municipalities to attract private investment to brownfield sites (for more information on US brownfield approaches, see Tomerius, 2001).

Figure 6.4. **Publicly-driven brownfield redevelopment focused on improving image in Lorraine, France**



Federal level: EPA brownfield programmes – tools and incentives for leverage of private investment

The Environmental Protection Agency (EPA) as the responsible federal environmental authority, has addressed the problem of contaminated sites on two levels. First, there are the most dangerous, highly contaminated sites, which are governed by the so-called Superfund Law. Second, EPA has established several programmes to deal with the much greater number of less-contaminated sites, called "brownfields".

The legal basis of the EPA Superfund Programme is the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), nicknamed the "Superfund Law". Sites that meet certain criteria of high contamination are listed and fall under CERCLA. Following the "polluter pays principle", CERCLA taxed the petroleum and chemical industries in order to create financial resources to defray cleanup costs from contributions by the main ground polluters. This was dubbed the "Superfund". More recently, new federal legislation passed in 2001 has amended CERCLA establishing two new acts, the "Brownfields Revitalisation and Environmental Restoration Act of 2001" combining three titles dealing with funding and liability for assessing and cleaning up contaminated sites. Title I expanded EPA's current Brownfield Programmes, title II exempted from Superfund liability for contiguous property owners, prospective purchasers and innocent landowners and title III authorised funding for state response programmes limiting Superfund enforcement authority at sites cleaned up under a state response programme. The second Act is the "Small Business Liability Protection Act". Exemptions from strict Superfund liability have been established for smaller contributors of hazardous substances and household, small business and non-profit generators of municipal solid waste.

EPA brownfield programmes and further federal department initiatives

The "Brownfields Revitalisation and Environmental Restoration Act of 2001" authorises up to US$200 million per year for assessment and cleanup. Grants of US$200 000 can be made to eligible entities (especially municipalities, counties, also non-profit-organisations and tribes) to inventory, characterise, assess and conduct planning at brownfield sites. Grants of the same amount may be given to eligible entities or non-profit organisations for clean up costs. In a subtitle "State Response Programmes" the new law also authorises US$50 million per year for grants to assist States and Native Peoples in the development of programmes. In addition to these grants, there are four other key elements in the EPA's Brownfields Programme.

First, there are EPA's 362 pilot projects. These are pilots in different regions having access to assessment grants. Each region is organised by a Regional Brownfield Co-ordinator who coordinates information and proceeding of EPA programmes in the relevant region. Having qualified as an EPA pilot a municipality clearly increases its chances of initiating brownfield projects through the grants mentioned. These grants help to attract private investment because assessment costs are funded by public money (for more information about EPA's pilot projects and grants, see Powers *et al.*, 2000; detailed current information on http://www.epa.gov/swerosps/bf/pilot.htm).

Second are the "Revolving Loan Funds" (RLF). Through these funds, cities loan federal money to projects. Repayments are ploughed back into the fund and used to support further brownfield projects. According to EPA there are 104 pilots participating in RLF. According to the EPA Brownfield Office, the EPA provided US$165 million in RLF within eight years up to autumn 2000. Leverage from follow-up investments is estimated at US$2.3 billion. EPA sees a major effect in the follow-up investments from the private sector stimulated by low-interest loans for brownfield projects from RLF. In addition, about 7 000 jobs have been created in the course of realised projects on brownfields. In the meantime an RLF loan amounts to US$1 million according to new brownfield legislation.

Third, the Job Training Programme is focusing on restoration and renovation of buildings, etc, often in brownfield sites. Some 37 pilots in disadvantaged communities have taken advantage of its US$200 000 grants. The participating communities can recruit workers for their projects out of the training pool.

Fourth, there is the "Showcase Communities" Programme. In autumn 2000 there were already 16 showcases. In the meantime the number increased to 28 (for more information on the showcase communities, see http://www.epa.gov/swerosps/bf/slocat.htm). A showcase community gets US$200 000 and has the advantage of close cooperation with EPA. Apart from that, an EPA member is sent to the city to support its projects. Another US$200 000 is granted to employ this person. Being a showcase community increases the chances of getting first hand information on EPA funding programmes. According to show case communities practitioners, benefits are the experience and expertise of the EPA official, again as a "matchmaker" between municipality and other funding opportunities. Furthermore, being a well-known "EPA Showcase" in the brownfield-community is seen as an important image-factor attracting private investment in brownfield sites.

A considerable number of grants, loans and loan guarantees from other Federal Departments, such as the Department of Housing and Urban Development (HUD) with its "Community Development Blockground Programme" and its "Brownfield Economic Redevelopment Initiative", Department of Transport (DOT) and the Economic Development Administration (EDA) may be addressed by municipalities, thus offering finance opportunities and supports for private involvement on brownfield sites [for more information on federal sources, see Northeast-Midwest Institute (Charlie Bartsch): http://www.nemw.org/brownfields_financing.pdf].

Tax incentives

Tax incentives also play an important role in EPA's and also other department's brownfield strategies. Several tax incentives and tools of tax-exempt financing are given on the federal level to induce investment in brownfield sites:

- Targeted brownfield tax expensing incentive (expensing of cleanup costs),
- Historic rehabilitation tax credits,
- Low-income housing tax credits,
- Industrial development bonds exempting certain public work facilities from taxes,
- Tax-advantaged zones offering incentives for empowerment zones and enterprise communities (HUD programmes).

Tax incentives are given on federal, state and local level according to the relevant legislation. They are often combined as credits and, especially on the state and local level, also as abatements throughout the different levels and thus may add up to respectable economic incentives for private investors.

State Level – incentives for private finance in voluntary cleanup programmes

As a reaction to very strict federal remediation standard and liability regulation, several states have established voluntary cleanup programmes addressing the brownfield issue with an approach that is more cooperative than mandatory. Standards of state voluntary cleanup programmes can be more flexible for brownfield sites, which do not fall under strict federal "Superfund" rules. Apart from parallels and even some positive sort of competition,

concerning financial incentives and liability protections for example, there are also significant differences in quality between the states.

Liability protection for investors and developers is one of the main instruments in various state programs to make brownfield redevelopment more attractive. Protection is offered if requirements for site investigation and cleanup standards are met. Liability issues are closely connected with the insurance market, a relationship that is just about to take effect in German brownfield management. Opinions vary about how effectively private insurance for liability protection is already working in the brownfields business. But some commentators argue that insurance for brownfield redevelopment has grown in importance in the United States during the last 5-8 years. Some insurance companies seem to have identified a new market since developers and investors are implementing projects on brownfields. According to various brownfield practitioners estimates of the risk of excessive costs for insurance have reduced because technology and methods of investigation have improved in recent years.

Particularly at state level, tax incentives and targeted financial assistance play a major role in offering convincing economic arguments for private investors to grow active in brownfield deals [cf. also Northeast-Midwest Institute (Charlie Bartsch): http://www.nemw.org/brownfields_financing.pdf]. Examples are business tax abatements (Michigan), remediation tax credits (Colorado), environmental opportunity tax abatements/rebate and offset for clean up costs (New Jersey), assessment, remediation and cleanup cost tax credits (Ohio, Illinois).

Three examples of state-sponsored brownfield development projects are highlighted below.

New Jersey

According to the New Jersey Department of the Environment the state has about 8 million inhabitants, and the population is expected to grow by another million within the next few years. New Jersey profits substantially from the fact that the cities of New York and Philadelphia are just across the river from the "Garden State". Many businesses are relocating to New Jersey because taxes on sales and real estate tend to be lower than in the New York and Philadelphia metropolitan areas. Some 60% of New Jersey's surface is already developed. Most of the Garden State is now zoned for residential purposes, jeopardising policies to protect farmland. In this context, full utilisation of the state's brownfield areas is a priority.

In the mid-1990s the New Jersey Department of Environmental Protection (NJDEP) established a *Voluntary Cleanup Programme* (VCP). Key elements of the VCP are a *Memorandum of Agreement* (MOA), in which the duties of public administration and investors are fixed on a contract basis and a *No-Further-Action-Letter* (NFA), in which NJDEP guarantees to take no further actions as long as the requirements agreed on are kept. MOA and NFA are flanked by important instruments of liability protection and financial incentives for investors and developers (Motiuk and Monaghan, 1997, p. 518).

Liability concerns were major impediments to bringing brownfields into productive reuse in New Jersey just as in other states. New Jersey State law therefore offers exemptions from strict liability for investors and developers who are not responsible for the pollution of the site. Liability protection is also offered to banks and other lenders as long as they did not actively participate in the former management of these sites. Thus the state guarantees to take no further legal actions if its site investigation requirements and cleanup standards are met. To date, none of those agreements have been challenged in court as violations of federal or state law.

In particular, during the mid-1990s a number of financial support measures were embodied in state law. These programmes mainly support site investigations and remediation measures and already ranged, in 1997, between US$1 million and US$2 million per year and entity (Motiuk and Monaghan, 1997, p. 521). New Jersey cities are allowed to offer real estate tax credits to investors. During a period of 15 years investors may get credits of 15% of the regular real estate tax for projects developed on brownfields. The cities' loss of tax revenue is more than compensated. They may lose 15% real estate taxes for 15 years, but there would not have been any significant tax income generated for the city at all if redevelopment had not taken place. This incentive is seen as a prime example of a "win-win situation" for the city and the investor.

Maryland's "Smart Growth Programme"

Maryland, a rather small state with 5 million people, located within the heavily developed Washington, Baltimore, Philadelphia, New York, Boston corridor, was one of the first states to deal with land use and brownfield redevelopment issues. Apart from burgeoning per capita property size, severe urban sprawl caused major traffic snarls. The state realised that this trend would cost taxpayers millions of dollars in construction of new infrastructure. The old adage of municipal and county planners that the increased tax revenue generated by population growth would completely pay for the new infrastructure (fire and police protection, schools, water, sewers, roads and other

utilities) turned out to be wrong. On the contrary, it was demonstrated in several cases that the infrastructural costs would exceed new tax income. Consequently, the state had compelling reasons to start with the "Smart Growth" approach in 1997 (see state government brochures: Maryland Office of Planning, Smart Growth Fact Sheets). The Maryland Department of the Environment developed an "Environmental Restoration and Redevelopment Programme" and a "Voluntary Cleanup and Revitalisation Programme" (Wilson, 1997, pp. 3-7; Maryland Department of the Environment, 1998; Maryland Department of Business & Economic Development, 1999). Ecological arguments alone would most likely not have convinced the authorities to revamp planning and developing procedures.

Avoiding a top-down approach, the Smart Growth programme is based on incentives for public and private investments. There are no strictly binding instruments. The only tool employed is tying access to money for necessary infrastructure and transportation funds to the programme aim, that is to fight further costly sprawl and concentrate further development on giving incentives for redevelopment of formerly used sites.

An important role is played by the *Priority Funding Areas* (PFA). These are districts that meet specific density criteria in order to qualify for priority funding. PFAs are designed to focus state development and financial resources on certain areas and thereby protect other areas from being used. The municipalities have the right to designate PFAs. In some cases their specifications are debatable, leaving loopholes for growth in certain sensitive areas. But state law dictates that state funds can only be allocated to areas designated as PFAs.

PFA requirements by state law are supplemented by executive orders of the governor, which is the law of Maryland as long as it is in place. It stipulates that every public programme and decision is to be reviewed for compliance with the PFA goal of protecting rural space. As a consequence of these rules several bypasses around towns already on the state transportation agenda are now excluded from state funding because they are beyond PFA borders. NJDEP sees this as a major shift from the traditional state policy to fund roads throughout the state.

The integrated approach to land use and transportation issues plays a crucial role in the Smart Growth approach. This is because the state transportation agency provides the largest share of the funds to the municipalities and their private partners. To tap this resource, projects now have to meet PFA-related Smart Growth criteria. "Smart" investors accepting the PFA approach are able to qualify for targeted public funding and thus may

benefit from lower investment costs for brownfield projects. This strongly encourages the leverage of private investment for brownfield development.

The Voluntary Site Remediation Program in Illinois

The State of Illinois has an advanced Voluntary Site Remediation Program (SRP) based on a 1995 state legislation that focuses on potential investors' need for certainty about potential remediation and liability risks (for details of legislation provisions, program mechanisms and incentives (Engel, 1997, p. 385). Cooperation between investors and city departments of environment and planning are usually linked to SRP. The main tool to give developers protection and long-term certainty for intended brownfield projects is the "No Further Remediation Letter" (NFRL) from the Illinois Environmental Protection Agency (IEPA). This letter serves as an agreement clarifying cleanup guidelines and standards. An important SRP advantage is flexibility in cleanup standards; the requirements are related to the intended use, meaning lower remediation costs for less sensitive uses. This approach prevents establishing overly strict cleanup requirements and definitely heightens the motivation and the chances of implementing brownfield projects. In practice, state and city authorities cooperate well in order to fulfil cleanup standards and procedures as soon as possible.

If guidelines and standards agreed on in the "No Further Remediation Letter" are complied with, NFRL offers protection against liability. State law precludes the state from seeking remedial activities or response costs from anyone other than the person who is responsible for the contamination of the site. In addition, joint liability for all parties who contributed to contamination is repealed and substituted by a "Proportionate-Share-Liability". This obviously significantly reduces the liability risks for a private investor. Furthermore financial institutions that acquire ownership, management etc. of a facility through foreclosure or security interests are not considered "owners" or "operators" according to strict Superfund and investor-deterring liability law (cf. details of Illinois Liability Protection Program and Laws in Engel, 1997).

Liability protection based on state law and NFRL also covers the discovery of unexpected contamination on the site. In this case the state, city and property owner are compelled to come up with a joint solution.

PPP strategies to attract private investment

As redevelopment is primarily a matter of finance, cities are eager to get the largest possible amount of funds and grants from the federal government and the states. Some cities are pretty inventive, especially in tapping the "Community Development Block Grant Program" (CDBP). This program is run by the U.S. Department of Housing and Urban Development (HUD). Low-interest HUD loans must be repaid by municipalities. Therefore, it is of utmost importance that profitable projects are implemented in suitable forms of public-private partnership so that loans can be paid back from increasing real estate tax revenues. A variety of additional state and municipal tax incentives are major instruments in stimulating redevelopment and private investment on abandoned sites. Examples are tax abatements, tax incremental finance (TIF, see the Chicago example below) and the targeted designation of special service areas and taxing districts offering chances of offsetting brownfield redevelopment costs for private investors.

Several cities have established regular meetings or forums for public and private brownfield stakeholders (e.g. Dallas and Chicago). Innovative cities have also become involved in remodelling old buildings and preparing them for reuse. They have deliberately kept legal hurdles low to foster competition for creative solutions and indoor uses. Very early in the game, buildings are opened for public inspection, giving potential purchasers and users the possibility to consider potential projects. This combination of construction and marketing has proved to be very successful. On the other hand, there are cities where the process of redeveloping brownfields is rather painful and fraught with uncertainties, often involving restrictive and complicated state law.

Problems in handling the brownfield issue often exist particularly in smaller towns and in areas that lack the necessary resources to tackle them properly. However, there are federal and state rural development programmes such as "community facility loans and grants" or "rural development grants". In some areas there is a tendency to "develop speculatively": cities remediate sites in advance to be ready for potential investors when the time comes. Some smaller cities are particularly active in employing this strategy.

The Internet is another avenue used to attract investors to developable sites. Several brownfield websites contain all the information a developer needs to decide to swing into action. The biggest redevelopment successes were reached because the projects matched and were integrated in a medium-range

city vision. Brownfield projects vary greatly and different sources of funds, grants etc. are used as the situation dictates. Strong public involvement is seen as one of the essentials for successful redevelopment projects.

From the perspective of improving public-private collaboration in order to drive economic regeneration in US cities the following issues are of particular strategic importance.

Improving public-private partnerships

Cities play a decisive role in matchmaking between public and private players. Linking development and state authorities is of major importance. Many cities have become quite successful at this by embedding brownfield redevelopment in a comprehensive plan for the city's future. They have become more proactive and more selective in deciding which use will be most compatible with long-term municipal perspectives. This point is also relevant for project acceptance and profitability. Redevelopment for short-term profits (like the third duplex cinema in the neighbourhood) may yield new abandoned, or at least under-utilised, sites in the future.

Clarifying the business perspective

A strong, still unharnessed, factor that could drive investment in brownfields is the explanation of the economic benefits of revitalising abandoned sites, especially from the city's perspective. It must be made more apparent that redeveloping inner-city areas will pay off by increasing the tax base, raising and stimulating quality of life and consequently attracting more business and human resources in the long run. Some amazing examples show that brownfield redevelopment can enliven run-down industrial areas, give them nostalgic charm and attract a number of companies and people. This gives municipalities the incentive to seek partnerships with the private sector for such investment.

Targeted financial incentives

Tax incentives are a major tool in lowering redevelopment costs and increasing the chances of brownfield reuse as opposed to new greenfield development. There is further need for targeted financial incentives. As mentioned above some states have developed innovative approaches to lure investors with tax reductions, abatements and transfers. Some of the best incentives can be found at the municipal level. Flexibility in legislation that allows cities to offer tax incentives has proved to be a driving factor in making brownfield investments economically enticing. Numerous examples prove that

tax incentives are definitely able to create “win-win situations” for the city and the investor.

Economic incentives in US city practice – brownfield redevelopment in Chicago, Illinois

According to the Chicago Department of Environment and the Chicago Planning Department, brownfield redevelopment is an important political issue for the mayor. His goal is to keep companies and jobs in town. Brownfield redevelopment is understood to be a means to increase the city’s tax base. There is also a socio-political aspect: run-down sites are adversely affecting the neighbourhoods because they often become the scenes of gang-violence, drug abuse etc. (see City of Chicago, 1995 and 1998). Brownfields are mainly located in urban areas, whereas most Superfund sites are situated in rural areas. The city of Chicago is the focal point of the State Voluntary Cleanup Programme.

From the strategic point of view, tax incentives play a major role in attracting investors to brownfield sites in Chicago. But competing incentives for greenfield projects are a problem. The tax increment and finances (TIF) approach (see the following points) was supportive in many projects. However, HUD loans have to be repaid. This reduces the city’s scope for offering tax abatements.

There is still uncertainty on the liability question although the state programme offers protection for lenders and owners who have not contributed to the pollution of the site. As a rule EPA only gets involved when the agency invests federal money in the site. Contacting EPA is then required and possible solutions are discussed with EPA project managers.

The City Environmental Department handles EPA and state funding. It has the task of bringing the different resources together, allocating them to specific projects and getting in touch with potential private investors. The department usually starts the project within the *Voluntary State Remediation Programme* (SRP). The main goal is to get a “No Further Remediation Letter” (NFRL) from the Illinois Environmental Protection Agency (IEPA) as early as possible. This reassuring letter provides definitive cleanup guidelines and standards. This is seen as a major factor of investment security to leverage private investment for urban brownfield sites. SRP is seen as a very practical programme because it relates the cleanup standards to the intended use. SRP supports the new owner of a site in many ways. NFRL also offers protection against liability as long as the guidelines and followed standards are met. This also applies if something unexpected is found on the site. As long as the purchaser did not know about or

is not responsible for the contamination, the authorities will not sue because of NFRL. The case is settled amicably between the state, the city and the owner.

State and city officials co-operate smoothly to clarify cleanup requirements as soon as possible. This gives potential investors a high degree of certainty. On this basis, consultants can be retained to work out site specifications according to the guidelines established by the agencies. By now, experience in remediation technologies and procedures has reached sufficient sophistication that potential risks do not prevent private investment in brownfields as long as funding and liability issues are appropriately handled.

Tax and Finance Incentives (TIF)

The City Department of Planning is taking a strategic approach and treating brownfields as part of a larger industrial redevelopment programme. After tremendous shifts in industrial sectors and structures the question for the city was where it should focus its industrial development. Planners designated 22 industrial corridors, including a number of brownfield sites. The next step was to develop strategic plans, focusing on the question of what was needed to attract new business and keep established industries in Chicago. In each corridor, business groups were formed. The City is closely cooperating with these business groups to build an area plan. Chicago uses various incentives, especially tax and financial tools, to improve the industrial climate. Special districts were designated where specific fiscal and financial incentives can be employed. In most of the corridors tax and finance districts were established.

The tax system works as follows. Property taxes from the districts can be frozen. When the property value rises above a given baseline, the tax amount may be split. The amount of tax collected from property values exceeding the baseline is used only on district programmes – as a means of reallocation of investment within the city. This model is called “tax increment and finances” (TIF) (City of Chicago, 1999). State law enables the cities to use TIF. The money that goes to the district this way can be spent on two broad categories of expense: infrastructure (roads, sewers etc.) and grants to investors or developers. Thus TIF can be tied to brownfield issues and the revenue can be used to cover cleanup costs. Developers can be reimbursed for financial efforts for assessment or clean up. As TIF money only flows when property values rise above the baseline, the City has to be resourceful to obtain money up front for its contribution to a development. A major source is HUD loans from the Community Development Block Grant Programme. The City thus borrows from HUD and then uses TIF to repay these loans. The HUD loans are used by the City to develop industry. As a result, revenue increments come from industry, enabling the city to repay the HUD loans. In addition to TIF, several tax

abatements are offered. Thus investors can also qualify for tax deductions on assessment costs for brownfield clean up. Chicago also reserves areas for industrial development in attractive locations near the city, preventing landowners from using the property for other purposes, for example for residential use. The City cannot rezone these areas as easily as other neighbourhoods.

Conclusions

Brownfield redevelopment is a topic of increasing importance for sustainable urban development in Europe and other OECD countries. Particularly in traditional industrial regions, the potential for redevelopment on derelict sites is growing in line with the internationally common structural change from industrial to service and information. In the minds of many planners and developers, consumption of greenfield land on city outskirts still bears advantages compared to a rather complicated procedure of redeveloping brownfields, often facing remediation uncertainties and liability risks. But at the forefront of modern urban development there are more and more examples of projects that are deliberately designed on derelict land in, often attractive, inner city areas. A strategic change in urban development to primarily revitalising derelict sites and a clearer political understanding of brownfield benefits for cities and regions are essential for the chances and effectiveness of development agencies active in brownfield redevelopment.

Taking up the challenge of brownfields needs both public and private actors committed to brownfields as a chance of revitalising inner city areas. Public-private partnerships in different European cities and regions give striking examples that brownfield redevelopment is able to compete with greenfield development. From a mid- and long-term perspective, the focus on developing the potential of derelict land within cities is beneficial, for example public transport and sewage often already exist in these areas, saving cities and citizens a lot of money. Furthermore the return on investment for city and region governments from revitalising brownfield sites is to be calculated. The benefits may be clear but still need to be conveyed more strongly into the minds of politicians, who are important drivers of brownfield projects. Apart from smart approaches in procedural management, PPP approaches are particularly needed in the key field that makes redevelopment happen: the field of financing. Against the background of serious budget problems in public sector strategies and instruments, leveraging private finance into brownfield redevelopment becomes crucial.

However, successful examples prove that smart planning and strategic public pre-investments in the area, improving the quality of the location through attractive and ecologically innovative mixed-use projects, may have initial detonations (see the “Inner Harbour Project” in Duisburg above): they qualify the area for private investments being done in an attractive, sound neighbourhood and sometimes in “hip” surroundings.

It has to be stated that the most appropriate policy for brownfield redevelopment depends on the type of project concerned. When it comes to PPP projects, providing stable framework conditions and showing win-win situations for the city and the private investor are crucial. This means stepping out of the classic planning routine including organising an effective and transparent redevelopment process by integrating remediation, liability and other legal aspects into urban planning and development. The targeted use of negotiations and mediation between the relevant public and private stakeholders are important instruments to streamline the process on the costly timeline of redevelopment and to give certainties for private project finance. Leveraging private finance in PPP projects requires strategies for acquiring additional public funding from available governmental programmes. As private firms regularly are not funded with public money directly, the establishment of good cooperation with local authorities as partners is crucial. Planning and development authorities/agencies must be able to state a time- and cost-effective redevelopment proceeding if private investors are to be convinced that brownfield projects will be profitable in the end. Effective tools promoting private finance also include brownfield registers with basic information about the development potential, legal and technical restrictions and the planning goals in the area.

Planning and environmental departments must develop co-operative procedures to offer certainty and project feasibility for private investors and private finance. The growing use of consensual instruments such as remediation and urban development contracts between investors, developers and local authorities. These contracts may offer flexible ways of streamlining the complex redevelopment procedures, agreeing on reuse-related remediation standards, and sharing risks and costs between the public and the private sector. In addition, marketing strategies highlighting the cost advantages of brownfields and the architectural charm of reusable buildings could lead private landowners including banks and insurance companies more into the role of developers urging the public sector to support brownfield projects. PPP working groups, at an early stage identifying common interests, interest clashes and potential – legal, technical, economical and political – project risks along the redevelopment process in business plans, have proved to be successful approaches to procedural management. Again, these “technical” improvements

are crucial to attract private investment on brownfield sites. The funding opportunities may be as good as one can imagine – most investors won't decide to go for a brownfield project if they could realise two "normal" projects on the greenfield in the same period of time!

As there are striking similarities, such as growing land consumption and the need to revitalise derelict land in inner city areas, across OECD member countries, it is worthwhile looking over national borders in order to identify smart approaches and "good practice" of public-private collaboration in using financial resources most effectively. Of course prevailing conditions in laws on planning, remediating and financing vary – sometimes quite a lot – in different countries. Furthermore, there are ideas and approaches of good redevelopment practice in PPP, which may be transferred or at least varied in other countries notwithstanding political, legal and cultural differences.

As for Europe, the common political and legal framework of the European Union could offer more Europe-wide chances to foster brownfield redevelopment in the near future. EU market competition policies and complicated legal questions on allowed or not-allowed subsidies should not raise further restrictions for PPP projects on brownfields. Moreover a deliberate change in European funding policies towards priority, targeted funding for brownfield redevelopment, thus offering greater opportunities for private activities on derelict land, could substantially help to step forward towards an economically, ecologically and socially sound physical environment.

As far as brownfield policies and particularly funding programmes in the United States are concerned the approaches of giving incentives for private finance seem to be of particular interest as a model for a modernised future framework on urban development in Europe and other countries. Particularly derived from the US regulatory framework this chapter highlighted several finance tools and economic incentives for a stronger leverage of private investments for brownfields. The key question – "May these approaches be transferred to other OECD countries?" – cannot be answered in this chapter. This requires investigation into the comparability e.g. of the legal tax framework, regulatory share of legal competences between Federal, State and local authorities etc. Germany is currently starting to explore US approaches in bilateral research cooperation on brownfields. But one thing seems to be sure: targeted economic tools in order to attract private investment on brownfield sites – as supporters "to make the brownfield deal" – seem to be the major strategic attempt to be made in the future. This applies particularly in times of serious public budget crisis. The necessary adaptation of the legal and programmatic funding framework to that goal of making the brownfield deal pay for public and private developers and investors should include:

- Cancelling of advantageous governmental subsidies for greenfield development and targeted financial assistance for brownfield redevelopment projects (e.g. bonus-malus-models like fees for greenfield consumption to feed into a brownfield fund)
- Establishing a greater variety of tax incentives for private investments for brownfield developers and investors (e.g. tax credits, abatements and offset of assessment, clean up and remediation costs etc., as mentioned above)
- More flexibility and competition for municipal incentives for private collaboration (deletion of legal hurdles, e.g. in giving tax incentives at the municipal level).

More room to move and a bigger playground for the municipalities and their agencies to play with economic incentive tools to attract private investments for brownfields are still needed. A targeted set of instruments will play a more harmonious melody to be enjoyed by more private investors.

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CHAPTER 7
CITY BUILDING IN NORTH AMERICA AND EUROPE

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This chapter compares North American and European approaches to engaging the private sector to help in the task of "city building" through community building, brownfield redevelopment, and SME development and identifies a number of general best practices.

European and North American cities share a common interest in the desire to attract investment and be competitive economically. For decision makers on both sides of the Atlantic, cities are now acknowledged to be not just engines of growth but a real-time indicator of social cohesion and cultural staying power. Recognition of the common core of urban revitalization efforts is reflected in three different but complimentary areas: community building, brownfield redevelopment and the development of small and medium-sized enterprises (SMEs).

The traditional approach of relying on public policy tools such as loans, grants, housing subsidies, social assistance and job training has enjoyed mixed success. For more than 15 years, policy makers on both sides of the Atlantic have experimented with these initiatives at different scales: the contaminated industrial site, the derelict waterfront, the run-down neighbourhood, the vacant downtown and even the under-performing region. A more recent trend has emerged, however, which is an improved understanding of the role and opportunity to engage the private sector in the financing and delivery of urban policy initiatives. A comparison of North American and European efforts at encouraging a greater role for private sector in urban revitalization is the focus of this chapter.

Traditionally, the private sector steered clear of blighted urban areas. High crime rates, low levels of education, derelict buildings, abandoned industrial land, a declining economic base, and even the influx of new immigrants have all been cited as reasons why the private sector would not invest. For the private sector, these risks were considered too great to justify any meaningful investments in these areas, and, as a result, community building, brownfield redevelopment and SME development were seen as the responsibility of government. More often than not, it was easier to leave the problems behind in the city and move to where economic opportunity was less constrained.

Yet this does not explain why many of the same communities and cities where government met only limited success in their revitalisation efforts are now experiencing economic and cultural resurgence. A number of reasons have been cited, especially the role that individual political leadership has played in urban renewal and revitalisation efforts. However, where sustained success has been achieved – measured by reduced unemployment, new business formation, and large scale reuse of industrial wasteland – the private sector can be seen as playing a key role as investor, partner, and as primary instigator for change

This chapter will look at how North America and Europe engage the private sector to help in the task of “city building” through community building, brownfield redevelopment, and SME development.

The first part of this chapter provides an overview of the four main instruments used across North America used to engage the private sector in city building. These include:

- Federal spending and incentive programs.
- Financial tools.
- Governance models.
- Targeted tax incentives.

The second part of the chapter will look at the European experience in responding to the challenge of urban revitalisation. This section looks first at the measures being taken by the European Union in the areas of "urban sustainability", spending on SME, brownfield regeneration, and the role tax policy of member states can play in encouraging private involvement in urban renewal.

The chapter will conclude with a discussion of best practices gleaned from the experience on both sides of the Atlantic, and some conclusions on the portability of some of the key features of the more successful approaches to city building.

The North American experience

North American cities in Canada and the United States are working hard to make themselves more competitive as economic centres and attractive places to live and work. New census data confirm that many U.S. cities – including New York, Chicago, Indianapolis and Columbus – have increased their population for the first time in half a century. Eight of the ten largest U.S. cities gained population in the 1990s. Many major cities are now growing at a faster rate than their suburbs. Even cities such as Cleveland and Philadelphia, often cited as classic examples of the blighted American city, have slowed or halted long-term declines in population (CEOs for cities, 2001).

While the U.S. federal, state and local governments lead the way in revitalizing North American urban centres, Canadian federal, provincial and municipal governments are beginning to recognize that they must take similar steps in order to keep pace, attract investment, maintain a high standard of living, and remain competitive. The programs tools and incentives discussed below are primarily American. However, since many are beginning to be

adopted in Canada, their success, or failure, could be an early indication of their portability, and suitability for other jurisdictions.

Federal spending and incentive programmes

Over the past decade, the US Federal Government has taken the lead on designing and implementing programmes that will drive urban redevelopment. Federal programmes have had enormous power to steer strategic investments in cities and stimulate private investment. Two of the earliest and most successful examples have been in place for a number of years – the Low Income Housing Tax Credit (LIHTC) and the Earned Income Tax Credit (EITC).

These tax incentives are credited as helping to rebuild and re-energise downtowns for those who live and work there. They have also been coupled with direct financial support and mechanisms to offset risks. The most commonly referred to federal programmes include:

- The Transportation Equity Act for the 21st century – Signed into law in 1998, TEA-21 has spurred billions of investment in highways, bike paths, transit system, and safety measures. TEA-21 replaced an earlier commitment known as ISTEA, which was focused on similar goals. The total amount spent under TEA-21 backed initiatives is $218 billion. Empowerment Zones – The Empowerment Zone and Enterprise Community (EZ/EC) Initiative couples business capital investment with targeted social investment to trigger community revitalisation. Over 20 economically distressed zones received US$3.8 billion to finance sweeping revitalisation and job creation programs between 1998 and 2000. The goal, yet proven, was to retain 90 000 jobs and spur US$20.3 billion in public and private investment.

- Incentive programme for brownfield investment – Beginning in the mid-1990s the federal Environmental Protection Agency led the drive to provide incentives to private developers for brownfield development. The EPA funded brownfield pilot projects throughout the United States, particularly in city cores. They also supported revolving loan funds that lent money from monies repaid from previously successful projects, developed job-training programmes, and built partnership with other levels of government and private associations. These programmes were often married to state and local programmes that provided additional incentives, loans, grants,

insurance to lenders, and tax credits (Onyschuk *et al.*, 2001, pp. 22-24).

The foundation laid by these federal spending initiatives has fostered a culture within U.S. cities to maximize opportunities by combining benefit of government programmes with the goal of leveraging private sector participation. For example, the City of St. Paul, Minnesota used a number of financial tools, programmes, and incentives, to revitalise its downtown, attract US$1.7 billion in new investment and attract 18 000 new jobs. This was accomplished through a combination of public funds and publicly administered program that created the right conditions and encouraged the private sector to help support the City's revitalization effort.

Financial tools

A description of the main financial tools developed for U.S. cities to encourage private sector involvement include (Onyschuk *et al*., 2001, p. 25):

- Tax abatements that provide relief from property taxes and other locally assessed levies for a set period of time.
- Local sales tax and personal and corporate tax exemptions.
- Fully tradable tax credits for affordable housing developments.
- Tax-exempt bonds issued by municipalities that exempt the holder from paying U.S. federal income tax.
- Tax increment financing (TIFs) that uses the anticipated growth in property taxes, generated by development in a specific area, to finance public-sector investment.

Of all these financing tools, tax increment financings, or TIFs appear to be one of the most effective tools in a state or municipality's financial arsenal. TIFs have traditionally been employed for numerous types of economic revitalisation efforts, and are playing a more prominent role in brownfield and infill development. The TIF process uses the anticipated growth in property taxes generated by a development in a specific area to finance public sector investment in the zone. TIF programs are built on the concept that new value will be created and that the future value can be used to finance part of the activities needed to create that new value, and that ultimately the new value will accrue to the jurisdiction's tax base. The ultimate benefit that a city derives

from TIFs is the successful redevelopment of an area and an increased property tax base after redevelopment project costs and obligations are paid (Onyschuk *et al*., 2001, p. 26).

TIF is primarily a tool for municipalities and their designated redevelopment authorities. A TIF can be used to pay for the upgrading of public roads and transit ways, as well as water and other utilities. The use of TIFs for this purpose helps to attract private investment that does not need to undertake costly front-end investments in infrastructure rebuilding. A TIF-sponsored project is often the central component of a larger redevelopment programme. By deploying a TIF for one project, a municipality is sending a signal to others that it believes the entire area will receive economic benefits. Since TIFs rely on increases to property tax values, then private developers operating within or adjacent to a TIF project will most likely see their values rise as well. The result is that the rising tide necessary to support a TIF will lift all the adjacent private sector boats. It is this trend that helps explains the success of cities like Chicago and others that have witnessed private investment over and above the public contribution. Based on the success in Chicago and elsewhere, TIFs are perhaps the most potent tool a municipality can deploy if it wants to attract private sector interest and investment in the pursuit of city building.

The City of Chicago is the American leader in deploying a broad number of city building initiatives. Leading this exercise has been Chicago Mayor Richard Daley who has used a variety of economic incentives to help local companies retain and create jobs. Chicago's experience has shown that tax increment financing is a consistently effective economic development tool. The City has come to rely on TIF, not only because it spurs private enterprise in areas suffering from blighted conditions, but also because federal funding for urban renewal programs has dropped 56% since 1980 (CEOs for Cities, 2001, p. 25).

Sixty-four TIF districts at the end of 1998 have helped to create and retain 20 000 permanent jobs in a variety of industries, and the results are visible across the city (CEOs for Cities, 2001, p. 25). TIF has prompted development of new movie theatres and shopping complexes; fostered the restoration of architectural landmarks and hotels; pumped life into antiquated industrial facilities and office buildings; and spurred new housing developments in areas that had not seen a new housing start in decades (CEOs for Cities, 2001, p. 25).

According to a recent report, the US$270 million in public dollars invested in the city's TIF districts generated US$1.7 billion in private spending. In other words, for every dollar the city has invested, the private sector has invested $6.30. Annual incremental property taxes within TIF districts have grown from

less than $2 million in 1987 to nearly $50 million. Without TIF, it is estimated that property tax growth in these areas would have been less than $5 million (CEOs for Cities, 2001, p. 25).

Governance models

The United States and Canada are using a number of governance models, administrative tools, and partnership strategies to encourage the private sector to invest in cities. These redevelopment authorities act like private sector operations, rely heavily on private sector input, and actively encourage private sector investment in pursuit of local needs.

These redevelopment authorities differ from the traditional non-profit community-based organizations used to encourage private involvement in urban renewal and community rebuilding. A successful example of the non-profit model is the New York based Local Initiatives Support Corporation (LISC). It was established in 1979 by the Ford Foundation and six corporations, and is the United States' largest non-profit community development support organisation. It has 41 local programmes working in over 100 cities and urban centres across the country. LISC mobilises partnerships to help local people rebuild deteriorated neighbourhoods. It provides funding and technical know-how to community development corporations (CDCs) and helps the CDCs to work with banks and local governments to build affordable housing, improve commercial and retail services and generate jobs and income for local residents. LISC serves as a vehicle through which the private sector gets involved in community revitalisation. Through strong relationships with over 1 600 corporations, foundations and public agencies, and increasing numbers of individual donors, LISC has raised nearly US$3 billion to support grassroots community revitalisation, 97% of it from private sources

Redevelopment authorities and similar partnerships take over where these non-profit organizations leave off. Created by legislation, the purpose of these authorities is to promote revitalisation and growth, and is usually focused on the downtown area. The redevelopment authorities are usually corporate entities that possess a number of powers designed for it to achieve its redevelopment goals. The most common powers include: expropriation; zoning and planning functions; administering public funds loans and tax credits; administering tax increment financing; and issuing bonds in support of development projects. They also incorporate a number of powers related to the actual development and management of real estate. These include; urban renewal activities in blighted areas; purchase, sale and lease of property; operation and maintenance of buildings; granting property tax exemptions; and encouraging job training.

The City of Boston's Redevelopment Authority works in partnership with neighbourhood residents, business owners, community-based organizations, and developers to provide a clear and integrated approach to economic investment that addresses the current and future needs of the city. The financial tools it uses to meet these goals include:

- The Boston Local Development Corporation (BLDC) small business loan program that lends between $15 000 and $150 000 for existing businesses in or relocating to Boston.

- The Boston Small Business Fund micro loan programme that lends between US$5 000 and US$15 000 to start up or existing businesses demonstrating a positive benefit to the city through job creation and/or providing needed community services.

- The BLDC loan participation programme with local banks that has approved over US$2.2 million in loans and leveraged more than US$4.7 million in bank financing.

A variation on the use of development authorities is partnership strategies developed with the private sector to revitalise a particular section of a city, again, normally a downtown, but also waterfront and other brownfield sites. The partnerships are typically run by the private sector, with the public sector the dominant owner of the land assets. The organisational structure relies on broadly based advisory boards covering a range of issues, but with a strong business representation.

These partnerships have produced a number of positive results. California uses a number of private sector collaborations to lead its revitalization efforts. These partnerships also work in conjunction with development authorities in order to access their tax-exempt bond status. Through the use of TIF and empowerment zones cities like Detroit have been to attract US$4 billion in private investment by leveraging a modest public financial contribution (Onyschuk, 2001, pp. 27-29).

The partnership model is being used in the City of Toronto, Canada's largest city, as it attempts to revitalise its waterfront. This is a partnership between the public and private sectors, and between the three levels of government – federal, provincial, and municipal – all in pursuit of the same goal: renewing Toronto's derelict waterfront of approximately 810 hectares of mostly underdeveloped land.

The Waterfront Redevelopment Corporation, jointly supported by the three levels of governments, will oversee all waterfront revitalization projects. It is modelled on successful waterfront projects in other cities such as London, New York and Barcelona that have shown that a separate corporation with a strong mandate to co-ordinate and oversee an integrated strategy is crucial to making waterfront revitalisation a reality. To fulfil this mandate the Corporation will be guided by the following principles:

- Implement a plan that enhances the ecological, economic, social, and cultural value of waterfront land.
- Create an accessible and active waterfront for living, working and recreation in a fiscally and environmentally friendly manner.
- Promote and encourage public input into the development of Toronto's Waterfront.
- Promote and encourage private sector investment in waterfront development.
- Ensure that ongoing development is financially self-sustaining.

Headed by Toronto financier Robert Fung, the Corporation is mandated to oversee an estimated C$12 billion redevelopment of the Toronto Waterfront, quite possibly the single largest project of its kind in Canadian history. The three levels of government have committed C$1.5 billion for the initiative, including C$300 million for four priority projects that are now underway. The Corporation's principal focus is on a 13 km area along the Central Waterfront.

The Corporation is a non-share corporation governed by a 10-member Board of Directors that is appointed by the federal and provincial governments and the City of Toronto. It will also be preparing a long-term development plan and business strategy for waterfront renewal. The development plan will be completed in conjunction with the City's precinct plans for the central waterfront. Both the development plan and business strategy will be subject to the approval of the three levels of government.

Successfully developing Toronto's Waterfront will also depend on the willingness of the City, the province and the federal government to give the Waterfront Corporation the tools it needs to develop the land and attract private investment. Toronto has limited experience in brownfield redevelopment, and a history of tackling but failing to act on waterfront revitalization initiatives. There is also very little experience with TIF and other financial tools. Similarly, the federal and provincial and municipal governments are somewhat reluctant to use tax incentives and other fiscal measures to attract private sector investors,

despite the need for C$12 billion in investment. However, if the three levels of government are willing, and make the necessary regulatory and policy adjustments, then Toronto's Waterfront project could be an ideal proving ground of the portability of US city building techniques that lever private financing.

Targeted tax incentives

The spending initiatives, programs, financial tools, and governance models referred to above deal primarily with brownfield redevelopment and community regeneration through investment in derelict lands, neighbourhoods and buildings. Efforts to support SMEs in North American cities are also a component of city building. In North America, the U.S. has a number of programs that looks at the employment challenges faced in urban centres. However, in Canada, the issues are different. Economic disparity does not reside in urban centres so much as in the different regions of the country. As such, the programs that provide the best tools for supporting SMEs in the urban context are, once again, derived from the U.S. experience.

In 2002, the Bush Administration renewed its support for urban regeneration through a number of federal programmes sponsored by the US Department of Housing and Urban Development (HUD). The main programmes are:

- The Renewal Community Initiative (RCI): a US$17 billion programme of tax incentives designed to stimulate job growth, promote economic development and create affordable housing.
- The Economic Development Initiative (EDI): this programme provides grants to local governments to enhance both the security of loans guaranteed through the Section 108 Loan Program and the feasibility of the economic development and revitalization projects they finance.
- The Brownfield Economic Development Initiative (BEDI): a competitive grant programme designed to assist cities with the redevelopment of abandoned, idled and underused industrial and commercial facilities with expansion and redevelopment of real or perceived environmental contamination.

These programs go beyond the Clinton focus on brownfield regeneration and investment in urban infrastructure and focus instead on encouraging

employment and economic development in urban areas through targeted tax incentives, primarily focussed on SMEs and those they are likely to employ.

Each federal incentive is tailored to meet the particular needs of a local business and offers a significant inducement for companies to locate and hire additional workers The belief is that expanding business development and commerce will lead to greater job opportunities for residents and to improve access to goods and services, both of which will help energise long-term revitalisation. The tax incentives are only available to businesses operating in 40 Renewal Communities and eight federally designated Enterprise Zones and those hiring residents in those areas. Some tax incentives apply to labour intensive business, while others apply to those with capital needs. Some are for small business, while others are for larger ones (US Department of Housing and Urban Development, 2001, pp. 1-2).

The different categories of tax incentives under the RCI programme include:

- Wage Credits targeted at hiring local workers and encouraging welfare-to-work strategies.
- Deductions for commercial revitalisation and environmental cleanup costs.
- Bond financing in support of Enterprise Zone Facility bonds.
- Capital Gains exemptions on assets and stock.
- Tax credits for investors in Community Development Entities.
- Low income housing tax credits for new low-income rental homes.

One of the cities selected under this new programme is Philadelphia. It will receive regulatory relief and tax breaks to help local businesses provide more jobs and promote community revitalisation. As a federal designated RC, Philadelphia can also take advantage of wage credits, tax deductions, capital gains exclusions and bond financing to stimulate economic development and job growth. The City of Philadelphia will continue to focus on the personal property tax, wage tax and general business privilege tax. It will also continue to use tax abatements, and leverage existing tax incentives, including Pennsylvania's state-designated Keystone Opportunity Zones and Enterprise Zones.

The Clinton Administration relied on a combination of grants, loans and tax incentives to achieve its urban renewal goals. The Bush Administration, though, has shifted towards tax incentives and community led initiatives to achieve the same results. It is not yet clear whether this focus on tax based incentives will achieve the same level of success as a combination of grants and loans designed to create the right conditions for the private sector to invest in city building. Nor is it clear how much of an impact the tech fuelled economic growth of the 1990's influenced the investments made by the private sector in U.S. cities. Although a detailed comparative assessment is beyond the scope of this chapter, it is possible to conclude that whichever approach is shown to be more successful, leveraging private sector involvement in city building is the shared goal of each administration.

The European experience

The majority of European citizens live in urban areas. Cities are centres of economic growth, but at the same time face concentrations of social, environmental and economic problems. The European Union (EU) is contributing to the regeneration of European cities by promoting a policy of "sustainable urban development." This policy aims at better-coordinated and targeted community action for urban problems. The EU recognizes that many of its policies have important urban relevance, and that it has to take into account the potential of urban areas and the challenges facing them (European Commission, 1999).

Urban sustainability

In 1998, the EU adopted a "Framework for Action" to increase the effectiveness of EU policies by making them more "urban sensitive" and ensuring that they facilitate integrated urban development. The EU Framework for Action for sustainable urban development aims at better coordinated and targeted community action for urban problems and is organized under four interdependent policy aims.

1. Strengthening economic prosperity and employment in towns and cities.
2. Promoting equality, social inclusion and regeneration in urban areas.
3. Protecting and improving the urban environment towards local and global sustainability.
4. Contributing to good urban governance and local empowerment (European Commission, 1999).

The EU's desire to promote "urban sustainability" is not an attempt to take on new responsibilities for urban matters or to design specific urban definitions or solutions on the European level. Specific urban definitions or solutions had to arise out of local situations and with the support of each Member State. Rather, for each of these four aims the Commission proposes to improve expertise and implementation capacity and encourage the exchange of experience between all the actors involved (European Commission, 1999).

One of the key recommendations of the Framework for Action is to use the Structural Funds to promote cities as the centres for regional economic growth and innovation. Between 2000-2006, the EU will devote €286.3 billion in support of structural policies. In the past, explicit inclusion of the urban dimension in mainstream Structural Fund financing has been the exception rather than the rule (European Commission, 1999).

The only EU programme specifically focused on urban regeneration is the URBAN Community Initiative. URBAN I ran from 1994 to 1999. Under URBAN II, which will run from 2001 to 2006, the European Regional Development Fund will invest €725 million in 70 programmes across the EU. These 70 programmes are in areas suffering from severe deprivation with high unemployment, high crime, large immigrant populations, and limited green space. Funding will concentrate on physical and environmental regeneration, social inclusion, training, entrepreneurship and employment. Through co-financing by national and local governments, and the support of the private sector, the EU expects to increase this investment to €1.6 billion.

It is, though, unclear just what portion of this growth of investment will come from the private sector. The European Investment Bank (EIB) Structural Loan Fund and its SME Global Loans Programme have supported the social and physical infrastructure of cities, as well as the SMEs that choose to operate within. However, there does not seem to be any EU level programmes designed to encourage private sector investment in urban renewal projects, whether they be brownfield development, SME, or community regeneration through the construction of new housing or businesses on the scale of North American, especially U.S., extensive offering of grants, loans and federally sponsored tax incentives. Nor does there exist any EU sponsored programs that are specifically designed to attract private sector investment and involvement over and above that which comes from publicly sponsored sources. An example is the lack of financial tools or incentives at the EU level to reclaim urban lands or encourage brownfield redevelopment, the foundation for the North American success in city building.

The Member States and their cities, such as Italy, the United Kingdom and Barcelona, have adopted their own programmes to attract private sector involvement and investment in the task of community renewal, brownfield redevelopment and encouraging SMEs in urban centres. In Italy and the United Kingdom, brownfield redevelopment has been undertaken with the private sector as a full partner. In Barcelona new governance structures and authorities have been established to fulfil community renewal objectives. And again, in the United Kingdom, tax incentives have been introduced to spur SME and economic development in urban centres.

Brownfield strategies

In Italy, many initiatives are driven by municipal governments in the northern region that have been hard hit by an economic downturn in recent decades (National Round Table on the Environment and the Economy, 2003). These activities typically involve the private sector, community groups and public authorities. The municipality of Milan has been particularly active in brownfield redevelopment, constructing 4 300 housing units, four urban parks and commercial services on former brownfield sites. Mainly private companies have invested about 700 000 euro.

Challenges to brownfield redevelopment in Italy remain. There is an absence of specific redevelopment programs; insufficient technical, legal, liability and administrative references; limited participation by the public; lack of incentives for investors; developers' preference for greenfield sites; and overcoming the stigmas associated with brownfield projects. But the desire to have the private sector involved makes it likely the lessons learned from projects in Milan and elsewhere can lay the foundation on the continent for further efforts to encourage private sector involvement in city building.

In many urban areas of the U.K., the redevelopment of brownfield sites is led largely by the private sector.[4] A significant proportion of projects take place with very little direct involvement from public bodies and government agencies, except in their roles as regulators, issuing and enforcing necessary approvals and legal permissions (such as town and country planning). This private sector focus may be the result of a combination of the following four factors:

4 Cleaning up the Past, Building the Future: A National Brownfield Redevelopment Strategy for Canada, pp. A-23 to A-25.

- The fact that most of the current brownfield land stock is already privately owned.

- The particular "economic history" of the sites and the industries that were formerly on the land.

- The current state of the national and regional economies and, in particular, the demand for land in urban areas.

- Conscious political choice by successive national governments.

Public sector regeneration agencies and local authorities carry out projects including "fully worked up" developments; the preparation of "development platforms" for subsequent development by the private sector; simple site clearance projects; and the provision of roads and other infrastructure on or near potential redevelopment sites.

Financial support for the private sector does exist and can take a number of forms, such as:

- Grant aid, either for particular elements of the costs of development or as "gap funding".

- Support for loans, including payment of interest and guarantees.

- Other guarantees (e.g. income stream guarantees, support for warranty purchase).

- Partnership projects with risk and profit sharing.

Direct public funding is generally provided by national government through arm's length public sector regeneration agencies, such as English Partnerships and the network of regional development agencies in England, the Welsh Development Agency and Scottish Enterprise. In some cases, the funding is provided through local authorities, either directly from national government or via the national or regional regeneration agencies. In addition to these national sources of funding, other projects receive support through Objectives 1 and 2 of the European Regional Development Fund and other structure funds.

Recent years have seen a slowdown in government funding for private sector schemes due to legal problems. The European Commission has identified the main programs involved as "state aids" and therefore potentially contrary to

European Union competition policy. This means that the programs, and in some cases individual projects, have to be approved in advance by the Commission. The move also places strict limits on the geographic availability of financial support for private sector development and on the amount of support for any individual project.

Other indirect financial tools have been used in the past, such as tax breaks for development projects in designated "enterprise zones." The 2000 urban white paper committed the national government to investigating new fiscal instruments, in particular sales tax reductions for properties in economically disadvantaged areas and tax credits for cleaning up contaminated land. The *Finance Act 2001* has taken forward this second idea, allowing companies to offset 150% of the cost of remediation contaminated land against the profits on which they pay corporation tax. In some cases, this tax allowance can be claimed as a payable tax credit.

Governance models

Barcelona has combined all aspects of encouraging private investment in city building. Since the Olympic Games in 1992, which gave Barcelona an economic boost and developed the capacity to undertake large-scale infrastructure projects, Barcelona has come to be recognized throughout the world for its leadership. However, Barcelona is not content to rest on its laurels and aims to maximize the long-term economic benefits flowing from the Olympic Games.

The City of Barcelona and the Catalan Parliament have recently approved a City Charter, which provides the City with specific powers that cover the new demands, and needs of a large urban centre in the new millennium. Barcelona believes that urban transformation will foster the development of new occupations and economic opportunities in strategic sectors. A clear example of this is the massive renovation project of an old industrial area in Poblenou called "22@bcn."

22@bcn is currently Barcelona's most important undertaking. This major brownfield regeneration covers an area of about two million square metres and includes 117 city blocks. The project integrates leisure, housing, commercial property, proximity to a logistics centre and a new university in addition to value-adding business services. Changes were made to the classification of industrial areas, and incentives were provided to attract knowledge-dense activities. New urban planning standards also provided for the full re-urbanisation of the sector, and established the duties of the landowners. The

plans give priority to sustainability criteria, sound pollution control, energy savings and provisions concerning mobility, energy, communications and water and waste treatment. A private municipal company, 22@bcn S.A, was established as an independent legal entity provided with all of the instruments and powers required to administrate the process of transformation of the "22@bcn District of Activities". Finally, financing the transformation will be shared between the public and the private sector, with 30% coming from the public sector and 70% from the private owner of the land under development (Canadian Urban Institute, 2002).

UK urban regeneration initiatives

In addition to brownfield initiatives, the United Kingdom has undertaken a number of initiatives and programmes designed to address the problems facing towns and cities across the United Kingdom. In the 2001 budget, the UK Government put in place a number of policies to help regenerate towns economically, socially and physically:

- Economic regeneration – by encouraging enterprise and innovation in urban areas through the proposed Community Investment Tax Credit and Regional Development Agencies;

- Social regeneration – tackling social exclusion and deprivation through direct investment in public services and infrastructure through programs such as the Neighbourhood Renewal Fund;

- Physical regeneration – by introducing targeted tax cuts in stamp duty and VAT, and introducing capital allowances and tax credits.

More significant than the renewed commitment to urban regeneration was the introduction of a "major innovation in the UK tax system" worth £1 billion over five years. The main features of the programme include:

- Community Investment Tax Credits aimed at creating incentives for private investment to deprived areas through intermediary Community Development Finance Institutions.

- Creating 2 000 enterprise neighbourhoods across Britain, primarily in high unemployment areas.

- Abolishing the Stamp Duty in selected deprived areas.

- Providing urban regeneration VAT relief to help bring residential properties back into use.

- Accelerating tax credits for cleaning up contaminated land by making 150% of the costs of remediation of land tax deductible.

- Introducing a Landfill Tax Credit Scheme for registered landfill site operators to claim credit of up to 20% of their landfill tax liability.

- Provide a 100% first-year, capital allowance to renovated empty flats above shops.

- Create Urban Regeneration Companies that will have further corporate tax relief.

- Introduced the £40 million Bridges Community Development Venture Funds, supported by £20 million of government money and £20 million from private investors, to invest in businesses that will regenerate local economies in the most deprived areas of England.

The UK Urban Regeneration Initiative is modelled on the US experience that combines public dollars and targeted tax incentives for individual homeowners, local businesses, and real estate developers are the best mechanisms to encourage private involvement in supporting the SME component of city building

Best practices

From the successful projects and initiatives in the United States, Canada, the United Kingdom and Europe, certain best practices have been developed that will lever private involvement and investment in community building, brownfield regeneration and SME development in urban areas.

- Work with all affected stakeholders – government, private investors, not-for-profit organisations, local residents, and businesses – in identifying both scope and need.

- City building efforts should ensure long-term economic, environmental and community sustainability, and not just fulfil social needs.

- There must be strong, identifiable public and private sector leadership at the federal, state/provincial, local, community and business level.

- Adopt governance models that draw upon private sector skills and experience with the authority and financial tools to get the job done;

- Develop and use a wide array of local financial tools – grants, loans, insurance, and tax incentives. Public dollars are not sufficient. Properly designed tax incentives are essential if private dollars are to be leveraged.

- Once the community has decided on the goals and objectives, adopt a business-like approach to delivering the results. This will help reduce political interference, and give confidence to the private sector when being asked to invest.

- Design programmes with the expectations of the private sector in mind at the outset – this includes an understanding of how the private sector views risks, prevailing market conditions, financial returns, and the overall investment climate. The private sector is not geared to directly solve social needs. It can, though, be harnessed to deliver socially beneficial outcomes, provided its underlying requirements are respected and met.

- Locally administered tax incentives – TIF, property tax exemptions, wage credits – are as important as federal or state level incentives. Local communities have a vested interest in making sure urban renewal efforts succeed. The judicious use of their taxing authority – either by local governments or their designates – to encourage private financing will ensure that measurable results are in fact achieved, Most importantly, localised financial tools depend on the success of the entire undertaking in order to provide both repayment and a return, thus sharing amongst the public and private sector the risks and rewards associated with the efforts.

Conclusion

Encouraging private involvement and investment in city building will depend on the willingness to embrace certain key aspects of the programmes that have been a success in both Europe and North America. Public expenditure and other financial incentives targeted at housing, jobs and wages, brownfield revitalisation, and economic development that recognise the unique needs and

attributes of urban centres are common to both sides of the Atlantic. Targeted tax incentives and credits, to lever private financing for community building, SME development and brownfield regeneration are of a different order. It is also the one policy that may turn out to be the least portable. Spending and non-tax financial incentives are more in keeping with the way governments attempt to address policy challenges. However, of all the tools and strategies discussed here, tax driven solutions are the only ones that speak solely to a private sector audience. In other words, it is unlikely that a jurisdiction seeking to duplicate the successes experienced in North American and UK cities can enjoy similar results without them.

The range of policy tools designed to help cities thrive and prosper at the beginning of the 21st century is more complex and innovative than ever. Leveraging the private sector contribution to help renew and revitalize cities is a significant trend. It represents a major shift in how to make cities more liveable, more prosperous, and more sustainable. Governments of all levels and political stripes and on both sides of the Atlantic may share these goals. The challenge, though, is the willingness to adopt the measures that are perhaps the most provocative, yet likely to achieve the best results.

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CHAPTER 8
TRANSATLANTIC COMPARISONS

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Leveraging private finance into cities and regions is a fundamental imperative for governments of all kinds. Each city and region starts from a different position in terms of financial powers and frameworks and political cultures. Each therefore needs a set of instruments adapted to its own situation. The main implication is that policy learning should be undertaken in a careful and considered manner, with due attention paid to context.

Introduction: cities and regions and the territorial investment market

Leveraging private finance into cities and regions is a fundamental imperative for governments of all kinds. OECD countries, and their sub-national governments, are embarked on a quest for effective means to encourage private investors to view cities and regions as good places to secure a return on investment. Bankers, fund managers, and investment advisors are taking note. Investments that help local economies to perform better can add value to other localised transactions too, by providing a more competitive platform for business, raising local incomes and revenues, and improving asset values.

Mayors and regional leaders are now advocating economic development strategies that increasingly seek to perform the role of being "investment prospectuses" for their territories, demonstrating to financiers that they have the ability to grow in ways which can sustain borrowing to support economic expansion, and provide an acceptable return on capital deployed. Some local and regional financial instruments are already able to demonstrate a competitive performance relative to more established investment vehicles. Put simply, more private investment can help a city or region achieve more than public investment cycles alone can afford, especially in times of tight fiscal discipline. Local leaders and financiers have important business to do together.

It is a key task, therefore, of local economic development activity to make cities and regions both more "investable" and more "investment ready". "Investable" in that they need to clearly demonstrate how good returns can be made on investments in their territory, and be ready to help make those deals attractive. "Investment ready" in that they must become preoccupied with directly helping to stimulate a strong deal flow of good quality propositions for financiers to evaluate. Just as cities and regions still spend significant effort seeking to attract international corporate investments through Foreign Direct Investment (FDI) deals, they now need also to attract institutional and commercial investment into their locally focused financial instruments and assets.

The major changes in global economic development over the past decades have produced a different set of financing propositions at the local level from the past. Economic development in cities and regions is now much less about roads, bridges, and factories (which are tangible collateral), and much more about re-used brownfield land, high tech space, creativity hubs, science parks, supply chains, knowledge capital, small companies, joint promotion, and community development. These are less tangible collateral. They often offer more variable revenue covenants. Investing in these assets require something

new. The public sector can use its resources flexibly to help the private sector find means to commercially finance this new generation of job and wealth creation activities. National assistance through tax relief and incentives can be coupled with more localised participation in financial instruments to improve returns, or to reduce risks and costs, for private co-investors.

In some places this is happening more quickly than others: Catalan Banks have played a major role in financing the re-development of Barcelona, in New York City the financial services sector has been an important investor in community development successes, and fast growing smaller companies in Australia and New Zealand are seeing their growth supported by public and private capital programmes.

We've made some progress in London too. Our municipal pension funds are now significant investors in small capable firms and urban regeneration, our banks are providing patient capital for disadvantaged entrepreneurs, social housing in poor neighbourhoods is regularly financed through private debentures, bonds, and EIB lending, and community development organisations are starting to leverage bank lending for capitalisation projects.

We now know that investment opportunities that are principally territorial (localised) can be competitive for commercial finance when compared against other opportunities in business stocks and shares, government bonds, or other traditional investment instruments. However, there are credibility and profitability gaps, issues of scale and risk, and matters of cost and confidence, that have to be addressed if cities and regions are to attract private investment over the long term. A better flow of good local propositions (allied with clear investment instruments) has to be built if the local investment markets are to grow. Thus cities and regions themselves can become better at attracting private investment if they will diligently build the basic dimensions of a healthy local investment market. To do this, most cities and regions need help from their national governments, and robust advice from partners in the financial services sector.

For those seeking to build urban and regional economies, private co-investment can add important ingredients that are otherwise absent. Economic development programmes are increasingly moving away from traditional attempts to substitute for the absence of private investment, and are now more concerned with explicit attempts to leverage private investment instead. Tackling market failure through market making is the focus. Private finance is key to economic development because:

- It provides more capital than is otherwise available, more quickly, and more efficiently.

- It helps to rebuild local investment markets and averts other "disinvestment" from occurring.

- It builds a more sustainable finance strategy into economic development initiatives, allowing public funds to be gradually unlocked for alternative actions.

- It creates a greater commercial and professional discipline within economic development policies and initiatives.

- It attracts wider interest from other commercial players, giving confidence that something of value must be occurring which might merit their interest.

- It re-positions good economic development activity as an "investment", rather than an "expenditure", in the modern economy.

Cities and regions are therefore increasingly in search of the best propositions and instruments to attract commercial investment. Equally, for private finance providers, participation in economic development programmes can provide some important contributions to business strategy. It can:

- Utilise public sector support to help develop new business and markets sectors that would otherwise not be easily accessed, acting as R&D activity for future product lines.

- Contribute to diversification of the asset classes over which investment is spread.

- Contribute to achieving ethical and/or local investment priorities.

- Provide some predictable returns in periods of instability.

- Build relationships with a wider set of partners from which other business might evolve.

- Strengthen local and regional economies in ways which can safeguard or improve other investments, or expand the market for other financial services.

City and regional governments want to be in business with private financiers, and it is time to learn together about how to do this more effectively.

The international variations in the local economic development tool-box

The mandate to encourage cities and regions to pursue economic development objectives continues to grow. One manifestation of this is the huge range of new organisations being set up at the city and region level to promote economic advantages and unlock assets that are locally held. National and Federal governments are doubling or renewing their efforts to promote economic development at the sub-national level. Some commentators (e.g. Porter, 1995; Pierce, 1994; Ohmae, 1996) argue that, with the broad convergence of macro-economic and trade policies at the national and international level, cities and regions may become the most effective platforms for developing distinctive frameworks for commercial and economic success. Cities and regions may be able to differentiate themselves from one another in ways which nations, and federations of states, now find much more difficult. They may achieve very differentiated economic performance, and therefore provide distinctive investment opportunities.

This assumes that different cities and regions must have some distinctive and diverse assets and opportunities in economic development terms, and it also assumes that they might have relatively coherent and effective means to promote their own advantages and to be pro-active in "setting out their stall" in the international economy. Many are doing so, but are all equally capable of participating, and of succeeding? They may have the territorial assets and goals, but do they all equally have the necessary territorial development tools and means?

This has led many practitioners in city and regional economic development to engage in a substantive comparative conversation about economic development agencies and instruments (the tool-box). As one city, or region, comes to understand the achievements that another has had, the question "how did they do it?" emerges very rapidly.

> *"How did Philadelphia re-develop it's downtown so completely? How was innovation so fully engineered in Helsinki? Why is Toronto such a creative hub? How did Bilbao attract the Guggenheim? How could Sydney afford the Olympics? How come Johannesburg is succeeding again so soon?, and how is business investment in Shanghai structured and facilitated so effectively?"*

This leads to intense comparative analysis of whether one territorial economic development "tool-box" offers more potential to a city or region than another. For example, are cities in Europe capable of being as entrepreneurial as their north American counterparts?, and are the better organised regions of many parts of Europe capable of providing insights into how north American economic regions should now manage themselves? Can each provide a better locus for investment?

National governments seem particularly aware of what other governments have done and seem keen to adopt other countries' policy instruments at regular intervals. For many years, the United Kingdom has been borrowing public policy initiatives from the United States and Europe. In the realm of city and regional economic development in particular, American models have provided the impetus for many of the innovative approaches which have enabled the United Kingdom to be a leading exponent of urban economic development across Europe. In turn, European models of regional development, social partnership, local administration, and civic infrastructure have been developed and adapted to the United Kingdom as a focus for governmental reform and modernisation.

Thus, in the United Kingdom, Urban Programmes, the Urban Development Corporations, Training and Enterprise Councils and public/private partnerships all had their origins in the United States. Simultaneously, Regional Development Agencies, Regional Innovation Strategies, "Mutual Guarantee Systems", and R&D grants have been largely European imports. More latterly, Inner City Enterprise Markets, Community Reinvestment regulation and tax credits, Small Business Investment Companies, Business Improvement Districts, and Tax Increment Financing have received significant attention as the current crop of US initiatives which we are seeking to "borrow" from across the pond. Moreover, in the recent UK Urban White Paper (Department of the Environment, Transport and the Regions, 2000), our politicians demonstrated that they were more excited than previously about the achievements in cities such as Rotterdam, Barcelona, and Stockholm, and regions such as Emilia Romagna, North Rhine Westfalia, and Catalonia. Consequently, we, in the United Kingdom, are keen to borrow European models such as Regional Development Agencies and Regional Strategies, Urban Regeneration Companies, Neighbourhood Management, Public Realm and Urban Design standards.

It might be argued that the United Kingdom has gone from being a country that was relatively underserved in terms of city and regional economic development tools, to being one in which a vast matrix of North American and European inspired models are beginning to flourish. The tool box is starting to

grow, and British practitioners have become very curious about how to use it, and what to learn from those in Europe and North America who have invented the various instruments that were their origins.

A central aspect of these developments surrounds financing, and specifically the best means to increase the financing available for city and regional economic development, and to leverage private investment. In London, we have been investigating economic development financial instruments for several years now, trying to understand how to build a better incentive structure for private investors, and whether any North American, Asian, and European models might help. Private sector financiers have been key partners in our analysis and the results have been surprisingly revealing.

Financial tools and frameworks – major variations

Our first lesson has been to recognise that many cities and regions are starting from different places. Economic development financing tools for cities and regions are very different from one place to another. For example:

- Tax credits and incentives in the United States have tended to do the work that grant in aid does in the United Kingdom when it comes to urban re-development.

- Guarantee systems in Europe have tended to address the small business lending issues that, in the United States, are tackled through regulation.

- Town Centres investment mechanisms begun in Canada (and spread rapidly thought the United States) through clear statutory frameworks, have been achieved through voluntary partnerships, or chambers of commerce, in most of Europe.

- FDI deals which are sweetened with tax abatements in one place are supported with direct subsidies in others.

- Public bonds are issued in some countries to support the activities that in other countries are the preserve of private fund managers.

But despite these kinds of differences, two basic forms of innovation are emerging. Firstly, there is a continued push by commercial intermediaries and investment institutions to create non-governmental approaches which define and develop new localised investment markets where it is clear that good returns can

be made. Secondly, within government at various tiers, there are efforts to innovate with public finance in ways which will make it more flexible and sensitive to commercial thresholds, and thus leverage private investment more effectively.

Given that there is renewed appetite in both public and private sectors for financial innovation, it is worth beginning by understanding how cities and regions across the OECD member nation come to have rather different local development financial instruments. It is important to try to set out what some of the contextual variables are. Broadly these might defined as 8 key factors:

- Fiscal and financial authority is located at different tiers within prevailing public finance systems

- Methods for defining, calculating, and appraising public sector debt vary across nations.

- Habits of "ring-fencing" or "hypothecating" certain public funds or fiscal revenues for specific purposes are at varying degrees of being established.

- Mechanisms for attracting, appraising, and managing public/private co-investment vary significantly.

- Regimes for encouraging financial institutions to get involved in economic development vary widely

- Substantial variations in the extent to which public sector assets are subject to limiting controls about their sale, re-use, or participation in a financial transaction

- The development of single and/or free market agreements between nations have produced very distinctive outcomes in terms of the pursuit of parallel social and sub-national investment mechanisms.

- Political cultures vary in terms of appraising and accepting risk in relation to public sector investment in wealth creating activity and civic cultures vary in terms of how, and how much, popular support can be garnered for long term debt within more local tiers of public sector.

Each of these variables is discussed below.

1. **Fiscal and financial authority is located at different tiers within prevailing public finance systems**. For example, Canadian Provinces and US States have much more of the financial and fiscal power in their countries than do many sub-national governments in Europe, but have delegated macro-economic management upwards to their Federal Governments and Reserve Boards, whilst retaining a strong control of both federal budgets and fiscal strategies. However, on average (and despite some major variations between them) US States have delegated more fiscal power down to city and county governments than have their counterpart Canadian Provinces. This leaves Canadian cities often feeling bereft of the investment tools and incentives that their US counterparts enjoy. However, this does mean that Canadian cities and suburbs are less likely to use economic development initiatives to fight for tax revenues than do their US siblings.

   In Europe, there are such large variations between the EU 15 countries that comparisons are highly complex. At the extremes, there are highly de-centralised federal states such as Germany which, like the federal states in North America have very strong fiscal and powers at the State (Land) levels, with macro-economic management also delegated upwards to the Federal tier. However, some cities are also states (e.g. Berlin, Bremen, Hamburg) and these therefore are some of the most fiscally and financially empowered cities in Europe. Contrast the German system with that of the United Kingdom, Ireland, Portugal, or Greece, where the national central government holds almost all of the fiscal and financial power, and there is little financial autonomy for either cities or regions.

   In economic development terms, the key implication is that cities and regions simply have very different autonomies in relation to directly raising finance to promote development, or to vary tax regimes to incentivise private investment, depending upon the public finance system in which they are based. Cities with apparently similar economic development challenges and opportunities such as London and New York and Paris do not enjoy anything like the same abilities.

2. **Methods for defining, calculating and appraising public sector debt vary across nations.** In several nations (especially those that are fiscally highly centralised) all forms of public sector debt, at whatever tier of government, are considered as fully a component of the Public Sector Borrowing Requirement (PSBR) from the point of view of macro-economic management. This means strict limits on who can issue debt and how much can be issued (and the fiscal disciplines

required by participation in the European Single Currency simply reinforces this). Whereas for some, notably many US cities, and some from Germany, Italy, and Spain, public debt at the local level is not considered a part of national debt, there is more freedom. Although all national, state, and provincial governments take important steps to control public debt carefully, their treatment of the issuing of local debt varies enormously.

The result is that some cities in OECD countries can issue 30 year bonds to raise investment for infrastructure or major initiatives, whereas others can only really ever "beg or borrow" from their national or state/provincial governments, and others can only raise debt through non-public sector third parties. This leaves many cities and regions dependent upon the favour of their national governments for debt financed investment, often in the context of national policies which do not see the better performing territories as a priority for their limited resources. National debt issuing restrictions can therefore hold back well performing cities and regions (which could effectively service more debt) form taking the key investments that would enable them to achieve a more optimal rate of growth and development and remain competitive against the "world best in class".

Athens and Turin are both preparing for the Olympics (in 2004 and 2006 respectively). In Athens, only the national Government can borrow, in Turin the city can issue its own infrastructure bonds. The Greek Government has borrowed extensively to finance the Athens Olympics, but faced with wider national challenges this investment might not have been forthcoming. Turin's bond issuing programming has been key to investment in major infrastructures that would not be a priority for national debt to support.

3. **Habits of "ring-fencing" or "hypothecating" certain public funds or fiscal revenues for specific purposes are at varying degrees of being established**. An important additional variable in the fiscal systems is the extent to which revenues raised on the improved values achieved through economic developments can be either dedicated back to related developments, or the extent to which they can be varied (reduced or increased) in order to encourage or discourage activities in pursuit of economic development goals. This is an important variable that is at the heart of many economic development finance tools (e.g. Industrial Development Bonds, Business Improvement Districts and Tax Increment Financing). Some nations and states jealously guard the principle of "all taxation being general",

there is “one pot” for public expenditure. Others (e.g. Ireland) have started to develop from that stance towards a more hybrid model.

These kinds of freedoms provide important incentives for public private collaboration on Industrial modernisation, local competitive infrastructures, and commercial and industrial district improvements. Essentially, they can help foster more momentum in economic development by anticipating future benefits from local investment in the form of improved tax revenues and land values. These anticipated benefits can then be either borrowed against to finance key initiatives, or used to incentivise more immediate investment, creating a higher investment/higher return trajectory within a localised area.

Thus, the rapid redevelopment of key locations in Berlin has utilised a future profit sharing mechanism between public and private land owners to bring forwards early investment in redevelopment, Chicago’s transport and neighbourhood investment improvements have significantly anticipated future local tax revenues, and Toronto’s commercial centres have utilised the special assessment districts to create greater degrees of public/private investment.

4. **Mechanisms for attracting, appraising, and managing public/private co-investment vary significantly**. In some countries financial and fiscal de-centralisation has gone hand in hand with the development of precise mechanisms for public/private co-investment. For example, Small Business Investment Corporations and Community Development Financial Institutions in the United States are examples of local investment mechanisms that are “licensed” and incentivised by tax credits and public financial participation at the national level. The Regional Financial Institutions in Italy, Netherlands and Germany also provide coherent regional arrangements for public and private financial participation with national support. Building such mechanisms is essential to reduce due diligence and other transaction costs and to create clear templates of how risks and costs will be shared. However, in other countries national systems and models have been put in place. So, in the United Kingdom, for example, we have developed a sophisticated regime for devising and appraising public/private (financial) partnerships for investing in public service infrastructure, without significant authority for these being delegated below the national level.

5. **Regimes for encouraging financial institutions to get involved in economic development vary widely.** Many variations abound here.

In terms of regulation, the Community Reinvestment Act (1975) in the United States is probably the most developed regulatory regime for ensuring that Financial Institutions see economic development investments at the sub-national level as a priority. In Germany however, and in several other parts of the EU (Netherlands, Belgium, Italy), the focus has been upon creating specialist financial institutions such the Regional Investment Banks and Bank Foundations, and creating the framework for financial institutions to invest in them. This contrasts with the UK approach which has been to create or incentivise funds for specific purposes (e.g. through tax credits or public sector subordinated participation), such as Venture Capital Trusts and Regional Venture Capital Funds, also based on a US model, but without the regulatory stick.

6. **Substantial variations in the extent to which public sector assets, are subject to regulations about their sale, re-use, or participation in a financial transaction.** Public assets, and their control, are clearly an important dimension of any local investment climate. The common land use problems facing many cities and regions in the OECD countries are what to do with disused public assets that are retarding investment and causing blight. Some national regimes allow for such assets to be sold, or used, or traded, at below market prices in order to achieve certain economic or industrial development purposes, some do not. Others allow local public sector borrowing to occur to invest in the improvement of the assets before they are sold, some do not. Others still, allow the asset to be "endowed" to a third party so that re-development and commercial investment can occur, without a pre-determined return to the public purse, some again do not. One major effect of these differences is to radically alter the incentive structure for public agencies to manage their assets effectively, in economic development terms. In the United Kingdom, for example, the requirement to achieve the "best value" on the sale of assets often means it is hard to justify a usage which does not provide the "best price" for the asset, even though other uses might better promote local development.

7. **The development of single and/or free market agreements between nations have produced very distinctive outcomes in terms of the pursuit of parallel social and sub-national investment mechanisms.** Another important transatlantic variable concerns the extent to which the economic impact of free trade agreements (European Single Market, NAFTA) have sought to mitigate the uneven effect such polices have at the territorial level, and therefore

bring investment into city and regional development to redress these effects. The EU has made a substantial effort with the European Regional Development Fund and the European Investment Bank becoming significantly involved in promoting the development of local and regional economies in order that they better participate in the opportunities and benefits of intra-EU trade and an integrated EU economy. Whereas efforts to support cities and regions cope with the differential impacts of free trade in Canada, United States, and Mexico have been largely led separately by their three federal governments, and have been smaller in scale.

The fundamental impact of these variables have been felt in terms of the scale of investment and patience with which regional development has been pursued, especially in those regions most negatively impacted by freer trade. Ireland's economic success in the past 10 years has owed a great deal to the intelligent use of EU regional development subsidies. Athens Olympic investments are creating a modern and competitive southern European Metropolis thanks to European Investment Bank Investments, whereas a major question over an Olympic bid by New York or Toronto for 2012 appears to be whether the Canadian or US Federal Governments would provide sufficient financial support.

8. **Political cultures vary in terms of appraising and accepting risk in relation to public sector investment in wealth creating activity and civic cultures vary in terms of how, and how much, popular support can be garnered for long term debt within more local tiers of public sector.** Partly, as result of different traditions of public finance, and as a reflection of accumulated tolerance to pre-existing arrangements, there are widely varying views amongst politicians and citizenry about how much risk and debt a city or region should support. These partly reflect perceived fiscal and financial imbalances between those cities and regions and their higher tier governments, (for example, some would prefer a "rebate" of taxes that are seen as "subsidising" other cities/regions, others would prefer debt to be issued nationally to create investment capital to address their needs). Even in the United States (which is often deemed to be the "wild west" when it comes to incentives), most state governments (and their local government "subsidiaries") are not able to extend the "full faith and credit" of the government to enterprises or external investors. Generally, they do not guarantee debt with public funds. There are different views about what city, local, and regional governments are

for, and the extent to which they should try to "ride the business cycle" by bringing forward investment in lean times.

Taking these eight variables as a whole, there are substantial variations in the extent to which city and regional governments across Europe and North America are empowered to borrow, invest, save, lend, incentivise, and sweat their assets in the name of economic development. This means that cities and regions across Europe and North America *have very different levers at their disposal to encourage private sector investment in their economic development* efforts, and some have comparative advantages over others in their abilities and competencies to do so.

In addition to these distinctive variables, most countries have their experience of heroic failures: cities that have gone bust because they have borrowed more than they can afford, regional and city leaders who have invested in "grand projects" that have become "white elephants", loans to businesses and others that have never been repaid, and municipal speculations in stocks and shares that have failed to meet expectations.

However, this is not just an issue of what financial tools are in principle available. It is also quite clearly a matter of how well they are used, and whether they are being used to optimum effect. Some cities and regions with apparently equivalent financing tools at their disposal tend to use some better than others. Ireland's tax incentives, Chicago's Tax Increment Financing programme, New York's Business Improvement Districts, North Rhine Westphalia's Venture Capital Programmes, Piedmont and Lombardy's Regional Investment Funds, all appear to be examples of a particular instrument being fully exploited for local development purposes, and more so than neighbouring cities and regions who have the same set of tools at their disposal. The competence and expertise of the public sector appears to be a key factor here, with diligent programmes of capacity building and pump-priming being put in place to focus resources on making such tools work.

Are all economic developers doing the same things?

Given the extent of such variables, conversations about the merits of different means of financing city and regional economic development and leveraging private sector co-investment are going to be difficult to keep focussed, and much more work is going to be needed to really understand the full comparability of different approaches. However, it is useful to make some initial assessment of the effects these fiscal and financial variables may have on

how economic development is pursued at city and regional levels. Some initial points are:

The goals of city and regional economic development are substantially impacted. In those cities and regions within the most highly de-centralised fiscal and financial systems, economic development is at least partially a means to increase the income side of the municipal balance sheet. In other words economic development is a means of attracting tax into one location, rather than any other, in order that the local governments can invest and provide services to improve quality of life and attract further growth. Economic development is seen as a key fiscal contribution to an upward spiral of investment and growth. In other more centralised countries, no such fiscal imperative exists, and therefore the goals of economic development are much about tackling blight and unemployment, and improving productivity and prosperity more broadly. These two sets of goals are not mutually exclusive, but the "de-centralised" cities and regions are often more fraught with the dilemmas of alternative short term and long term goals to chose between. It follows that the decentralised states are more likely to try to incentivise private sector investment (they are more entrepreneurial) but not be able to resist short-term sub-optimal forms of investment, such as those with ethical and environmental down sides, (they may be less strategic).

The skills of city and regional economic development will need to vary. It is an obvious point that economic developers only need the skills for the task and the tools that they do have, rather than the ones their colleagues have in other countries. Without recourse to tax exempt bonds, special assessment districts, regional investment banks, or special multi-national assistance programmes, there is no need to be skilful in how to manage them, or the insights they provide on how to work with private financiers. Yet, there is a tacit assumption that across the cities and regions of the developed nations, we are basically trying to do the same things in economic development terms. Some better examination of the general transferable economic development skills versus the specific location skills required of an economic development practitioner would be welcome.

Is economic development an investment or an expenditure, or can it be both? At least in theory, those of us who earn our incomes from economic development in cities and regions, believe what we are doing can be "revenue positive" in the long term. If economic development is working, it is producing more benefits than costs, and it is reducing the costs in other areas of public finance (such as unemployment assistance and crime reduction). It is therefore potentially an investment rather than an expenditure, the argument proceeds. Business cycle dynamics will play a major part, but effective economic

development ought to be appraised in terms of returns against capital deployed, not its annual cost. This is not simply the distinction between "revenue and capital", or "capital and current", as is sometimes stated, but rather suggests a need to better model the whole costs and benefits of economic development programmes over the business cycle. There will be situations where economic development produces more benefits than costs within any year, in other situations it will take longer to achieve the returns, and in others it will act more as triage, retarding or averting worse scenarios form coming about, and building capacity for the future. These are different kinds of outcomes, and it is logical that different means to finance them may be appropriate.

The critical need is to develop instruments which can leverage private investment over and above what would have happened anyway. The science of demonstrating this, and the use of special investment instruments to meet market gaps, is a clear way of making progress. More effective evaluation is needed here.

Balance of tools between regulatory, financial intervention, governance, fiscal and financial incentives, etc vary significantly. Most economic development professionals will know that individual tools rarely produce tangible outcomes on their own. It is the combination of economic development actions, combined with a wider range of good governance measures and other responsible leadership that seems to really make a difference.

So there are quite large variations in terms of how the financing of economic development is undertaken, and how private finance is leveraged. Comparisons say, between London, New York, Berlin, Toronto, and Paris show that these five great cities each have a very different set of financing tools to use to promote their economic development. Berlin is a City State with significant freedoms over how much tax it raises and how much debt it issues, it has it's own regional investment bank (IBB), and it has considerable flexibility over how it deploys it's assets to further economic development. New York is also a financially empowered city with substantial freedoms granted to it by New York State. It can levy and vary taxes, raise bonds, cut fiscal deals with investors, and set up special assessment and tax increment financing districts. London, Paris, and Toronto fair less well in financial empowerment terms, although Paris is substantially supported by historically high levels of investment in the national capital by the French Government. Toronto has a history on innovating financially, but has been highly constrained by its need for long-term investment in the context of provincial conservatism which has not wanted to raise public capital. London is the most fiscally and financially constrained city of the group, but with a dynamic financial services sector, and a

regime which encourages private investment in public goals outside of public finance instruments, an alternative course is being pursued.

Does this mean that London or Toronto would be better off if they had the Economic Development financing instruments of New York and Berlin? It is tempting to say yes, but before doing so, we have to understand better how those instruments would work in a different context, and what consequences they might have.

Transferability of city and regional finance instruments

The issue of transferability of the economic development finance tools within and between the developed, transitioning and developing cities and regions is clearly a matter that is of great interest now. An international effort on the borrowing of policies and tools is indeed rife. But transferability of economic development finance tools is rarely undertaken in a considered manner, and costly mistakes have been made, most of them resulting in highly partial or sub-optimal performance of the initiatives taken.

The fundamental problem is that what is required is quite expensive to put in place and few national or sub-national governments can spare the resources or time to do it. What is needed is a "Policy Instrument Transfer Observatory" that asks tough questions and makes a proper assessment of the necessary conditions for success. For example, before borrowing another place's economic development financing tool it might be worth knowing a lot more about the context in which the instrument has emerged and the context into which it is proposed to be placed. This would need to include an analysis of the:

- general approach of private investors to local and regional economies.
- economic, social, environmental, physical, demographic and geographic conditions.
- business cycle dynamics in which it has succeeded or failed.
- administrative, political, fiscal, financial, and institutional arrangements.
- capacity, experience, implementation vehicles, and other aspects of the local scenario.

Without understanding these things fairly fully, it is quite difficult to assess how and why a financial tool has emerged and what the precise merits are that it has. Some things work well in the situation they are established in because they receive a lot of help from the local regime that may not be present elsewhere (for example, setting up local loan funds works best when banks have a real incentive to participate through the tax or regulatory system). Equally, some approaches work in the local system where they are precisely because of particular weaknesses in that system that may not be present elsewhere (certain tax based financing initiatives to encourage land redevelopment only work when the starting point is very low land values and minimal tax yields). Willingness to participate in programmes that seek an additional levy for an additional activity, will work better in governance cultures where "taxes for specific purposes" are not unusual. Profit sharing mechanisms with private landowners will be more effective when city and regional governments have shown their willingness to use their condemnation/eminent domain/compulsory purchase powers.

There is a general need for better evaluation of city and regional financing tools, especially evaluations that can be sensitive to issues of capacity and time frame, and can address enablers and inhibitors to success. Evaluation also needs to differentiate the performance of such financing tools from the economic cycle and also be much more sensitive to articulating at which point in the economic cycle certain tools are likely to work better.

The underlying metaphor here is one of an organ transplant. Surgeons who carry out these procedures know that they have to examine and prepare both the donor and recipient very carefully, and they have to stabilise the process with lots of monitoring and medicine.

Borrowing and transferring financing tools and policies from one place to another can be wasteful, and whilst the practice is rife it would not be wise for us to encourage an acceleration of this. Rather better would be to focus on "learning" rather than "borrowing" from practice, and to develop really useful learning interventions in which the policies and initiatives of others can be carefully examined in a collaborative manner. In particular, we have found it most useful to learn from talking with private financiers regularly, and in a structured manner. Some examples of policy transfer dilemmas that may illustrate these points are outlined below:

Business Improvement Districts were invented in Ontario Canada in the 1960s. They have been widely copied across the world and there are now nearly 60 000 worldwide. These districts offer a mechanism for financing and managing improvements to commercial and industrial locations through the

agreement by a majority of businesses (either land owners or tenants) to support an additional levy to produce revenues for special services. The additional resources often begin by supporting additional safety and sanitation services to improve the commercial environment and aid marketing, but they can also develop into much more sophisticated investments and initiatives (such as infrastructure improvements and promotional initiatives).

Once a district is established it then has the revenue at its disposal and can capitalise through long-term debt instruments for capital investment, or use it to finance additional services. In the context in which they were started and developed, BIDs work well most of the time. However, they are now being introduced into widely varying localities with different fiscal regimes, and with variable business partnership mechanisms. BIDs are not workable without a critical mass of businesses that are willing to pay and are used to being charged a wide range of fees for particular services. Equally, BIDs are good tools for reasonably healthy commercial and industrial centres that have tight boundaries and are densely populated by the owner/users. They are less effective for more spread out situations or for areas with a high degree of "mixed land use", where it is harder to capture the benefits of targeted improvements in services, and more controversial to have public and civic institutions (and residences) that do not pay, but do benefit.

In some countries where BIDs are being introduced, their role and scope is being overplayed, and as elsewhere, failure could be a major set back. Progress with BIDs in South Africa and the United Kingdom (both more centralised financial regimes than either Canada or United States where BIDs have mushroomed) is being considered carefully and a process of testing voluntary models is working well.

Small Business Investment Corporations were established in the United States in the 1970s to enlarge the venture capital available to early stage smaller companies with growth prospects. These too have been widely copied and there are now about 300-400 worldwide. The original intention in the United States was to trigger the market to respond, not to apply a permanent subsidy. The idea was that the SBICs would provide a spur to other institutional investors, demonstrating to them that reasonable returns were possible with such smaller firms. However, in many of the approaches that have copied the US version, most of the funds used have been public sector grants (even though the United States has moved over to a system of loans following its own evaluations which showed that the fund managers needed real commercial responsibility in order to make good investment decisions).

Equally, countries vary hugely on the legal regime that surrounds the introduction and exit of private equity into companies, and many countries have piloted successful alternative means for meeting growth capital requirements other than through equity investments. The fundamental issue that the US model is trying to address is the incentive structure for private participation in the financing of SME growth needs, and there are many other ways to meet this need other than by establishing special venture capital funds (though this is the preferred US approach). For example a national tax credit for such investments might work much better when combined with good mechanisms for introducing businesses to investors, as is working quite well with business angel networks in central Europe. Equally, public sector participation in guarantee schemes, or in the promotion of invoice financing, might (in some countries) be more appropriate means to secure greater private investment in small businesses at the local level. "Venture capital" means different things in different places.

Enterprise Zones were established in Britain in the 1970s and 1980s. These provide national tax incentives for businesses locating into a particular location to promote rapid urban re-development. In the United Kingdom, these zones were time-limited and offered incentives in a very small number of tightly defined locations which had been the beneficiaries of very large scale public investment in infrastructure, and site preparation, with the objective of creating new business locations. The zones have now been copied and adapted over 20 000 times throughout the world to varying degrees of success. Zones worked in a limited but clear way in the United Kingdom because they were a means to enhance an existing long-term investment of government. The major problem is that whilst the UK zones were very small and well selected on grounds of need and opportunity, the US zones, in particular, were much larger and more numerous. So their purpose was distorted from small area regeneration in the United Kingdom to a general business subsidy within a wider area. The lesson would be to have more tightly targeted zones.

In several countries the enterprise zones have been less effective because they were too widely used and did not augment other public investment; rather they became a substitute for it, creating a low cost-low investment equilibrium in some of the localities where they were used. The role of the zones in the United Kingdom was misunderstood and the value of the tool devalued. Many cities in developing and transitioning countries have found zones most effective when linked to a tangible benefit, such as a free trade zone linked to airport investments.

Conclusions

In the United Kingdom, we continue to try to borrow financing tools and techniques from cities and regions in other parts of Europe and in North America. In general, the introduction of new tools is to be welcomed, having more options is usually good. However, we know too little about where the overall the system of economic development finance is going, and what will leverage most private investment in the long term.

Looking forwards, it is possible to make some predictions with a reasonable amount of certainty. In the past five years we, in the United Kingdom, made substantial progress towards introducing some new tools that do leverage institutional and commercial participation into local and regional development. These include:

- Regional Venture Capital Funds.
- High Tech Start-up Funds.
- Regeneration Investment Funds.
- Community Development Financial Institutions.
- Community Investment Tax Credits.
- Business Improvement Districts.

The influences here have been more US than European (though this is not surprising), but lessons have clearly been learned from successful European models involving SME investment and the European Investment Bank is a partner in several of those cited. European best practices are more concentrated in long term design and planning of economic development, and the regional cohesion of efforts made.

Each of these will take some time to bed down, and it will be a while before any real evaluation is possible. However, we have learned from our colleagues in North America and Europe that some things are almost universally true with these kinds of financing tools.

Firstly, using special instruments and incentives to build the supply of investment capital is only one side of the coin, diligent work has to be done to stimulate and sustain a continuous level of good quality demand so that the average costs of each deal can be reduced, the scale of the opportunity will grow, and the scope for further investment will be created.

Secondly, achieving this kind of performance is only really possible with high quality intermediaries (the Fund managers, and others, who are really dedicated to

making it work). Attention to building up the capacity of the intermediaries (the economic development supply-chain) is key to making the instruments effective. Community Investment Tax Credits without Community Development Financial Institutions are a non-starter, as are Regional Venture Capital Funds without dedicated fund managers.

Thirdly, the mechanisms must not be rigid, they must be capable of adaptation in different circumstances and at different points in the business cycle. For example, public sector support may need to be calibrated to local investment climates. In some places, more public participation may be required to underpin the specific risks, costs, and returns, than may be needed in others.

Looking to the next wave of economic development finance transfer into the United Kingdom, and our unmet imperatives for private financial leverage, it is possible to make some informed predictions about what will come next. I would see variations on the following economic development financial instruments as the most likely contenders:

- Tax Increment Financing/Value capture finance.
- Securitisation of small business loans and investments.
- Real Estate Investment Trusts (publicly quoted and tax enhanced).
- Small Business Accommodation Funds (EIB enabled).
- Historic preservation incentives.

Given the pace of innovation in economic development finance in the past five years in the United Kingdom, the balance of the effort may now need to be placed on making what is already on the books work. Tax Increment Financing is probably the most likely short term addition to our toolbox, especially for large redevelopment sites where there is latent demand for new uses (a strong housing market), but also major infrastructure investment requirements. The latest view is that private investors feel that this may be quite a fair way to finance infrastructure.

Recent experience in the United Kingdom shows that we are borrowing financing tools for city and regional economic development from both North America and Europe, and we are not about to stop. Effective international learning between financiers, policy makers, and practitioners is surely now an important ingredient to ensure that our due diligence really reflects emerging practice.

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CHAPTER 9
CONCLUSION

by
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OECD LEED Programme

This concluding chapter reviews some of the instruments available and identifies a number of key lessons that should be taken into account if leveraging private finance is to be successful. The chapter examines in turn the issues of leveraging private finance into community building, SME support and brownfields regeneration before discussing the issue of the transferability of approaches and finally setting out some key overall messages for city and region policy makers.

The previous chapters provide an overview of issues and experiences in the leverage of private finance from a variety of cities and regions in OECD countries. It has been argued that there clear reasons why city and region authorities need to increase private sector leverage for economic development, not least among them being the pressure on public sector budgets. It has also been shown that there are many instruments and approaches available to the policy maker to attract private sector investment. This concluding chapter reviews some of the instruments available and identifies some key lessons that should be taken into account if leveraging private finance is to be successful. The chapter examines in turn leveraging private finance into community building, SME support and brownfields regeneration before discussing the issue of the transferability of approaches and finally setting out some key overall messages for city and region policy makers.

Leveraging private finance into community building

Community building involves support for economically disadvantaged neighbourhoods where normal market functioning is not delivering economic prosperity and quality of life. These communities require additional support to promote new investment in business growth and job creation, skills and training, affordable housing, retailing, services, amenities and so on.

A number of barriers exist to securing private sector investment in community development. These include:

- The lack of familiarity of investors with working in distressed neighbourhoods.
- The lack of historic performance data for similar investments.
- Preconceptions of risk and return based on mainstream assumptions.
- Low transaction size and complexity of projects, particularly if they involve public-private partnerships with a multiplicity of players.
- Low volume and deal flow.
- Lack of liquidity of investments.
- High risks compared with returns.

Some public sector intervention is therefore required to overcome these barriers. But, rather than investing alone, the public sector has a number of key levers it can use to attract additional investment and expertise into community building. These include:

- Community development funds to provide subsidies for private sector and other players willing to share the investment.

- Secondary markets in order to increase the liquidity of investments and access capital markets.

- Financial sector regulation to encourage investment in distressed areas.

- Promotion activities to change perceptions about investment opportunities.

- Creation of consortiums of private sector companies to pool resources in order to spread risk and create economies of scale.

- Creation of partnerships with not-for-profit intermediaries that can help create viable markets and lower risk by, for example, engaging the community, supporting training of beneficiaries, or accessing other forms of funding.

- A range of tax credits focused on specific target areas and activities.

In the United States, federal regulation through the Community Reinvestment Act (CRA) created a "critical turning point" in the level of private sector investment in underserved communities. This encouraged bank and financial services investment in distressed areas through a rating system and sanctions that could constrain the future expansion of banks performing poorly on this rating. Other OECD countries do not yet have similar legislation, but one of the lessons from this US experience is that once private sector investors started to get involved in serving distressed communities they soon learned that there were profitable opportunities there. Thus finding ways of simply opening the eyes of private investors to the market opportunities in distressed areas can have an important effect even without the (fairly light) regulatory stimulus of the CRA.

Another lesson from the United States is that banks often find it useful to work with intermediaries that understand and can help them access local markets. Community Development Financial Institutions (CDFIs) for example,

have been critical in enabling many banks to deliver against their CRA commitments. Similar intermediaries may play an important role in encouraging bank investment in community development in other countries.

When designing approaches to leveraging private finance, it is useful to tailor the public intervention to the nature of the barrier. As highlighted by Marc Weiss in Chapter 3:

- If the barrier is high risk, then such risks can be reduced through credit enhancement mechanisms such as loan guarantees or subsidised insurance. Similarly, building capacity in the not-for-profit sector can also reduce risk, since the non-profit sector often acts as a useful intermediary for private investors.

- If the barrier is the perceived lack of a market, then guaranteed demand is an appropriate solution. For example, it may be possible for local authorities to guarantee "fair market" rental payments on behalf of eligible low-income tenants participating in a development. It is also important to pull together a critical mass of developments at the same time in a community in order to reassure individual investors about the long term prospects for the area.

- If the barrier is lack of profitability due to the high costs of doing business in distressed communities, then policymakers can change these cost dynamics by providing subsidies to private firms in the form of below-market interest rate loans; direct grants; subordinated debt, or public loans that take a second or third position behind private lenders; equity investments on especially favourable terms; substantially reduced prices and rents for the sale or lease of land, buildings, and equipment; and tax deductions or credits.

- If the barrier is that financial transactions costs are too high, financing deals are too small for major institutions, and community development loans and investments are too unfamiliar for the comfort level of mainstream firms, then the solution is to create intermediaries that specialise in economic and community development financing to work as advisers to and partners with private investors and financial institutions. These intermediaries can be either government agencies or non-profit private entities.

- If the barrier is lack of a proper vehicle that provides an attractive risk-adjusted return, then the solution is to create such a targeted vehicle. In the United States, limited liability partnerships or syndicates, which

protect a certain group of private investors from the broader financial risks and exposure faced by general or managing partners, have been established to enable investment vehicles to attract capital for community development. Creation of secondary markets can also be very effective in expanding the range of institutional and individual investors that will provide private capital for selected activities.

A further critical message is that community redevelopment activities should not be isolated initiatives, but should be placed within comprehensive economic development strategies. As highlighted by Marc Weiss, such economic development strategies must recognise that:

- An individual urban community can only be improved if it is connected to and benefits from the larger economic dynamics of the entire metropolitan region.

- The key to generating and sustaining economic value is building on strength by investing in the fundamental assets that make a community special and competitive, and the most important asset is the people who live and work in that community.

- Promoting new development must be tied to attracting and retaining businesses and jobs, and to attracting and retaining a mixed-income residential population.

- The best way to attract and retain businesses and jobs is by fostering and sustaining the growth of dynamic industry networks or clusters that generate productivity and innovation.

A final key issue that arises in the field of community building is whether development works for people or for places. In the past, the public has often been successful in leveraging private investment for commercial or residential development in distressed communities but at the expense of the low-income population originally living there, who may be forced to move to other distressed communities through a process of gentrification. In order to avoid this outcome, it is important to work directly with the existing population and include them as full stakeholders and partners in the planning and policy-making process.

Leveraging private finance into SME support

In Chapter 5, David Walburn identifies three main areas of policy which tend to concern public authorities in the area of SME support:

- Improving small firms' access to finance.
- Providing good quality, affordable and suitable accommodation for growing small businesses.
- Creating and supporting micro businesses.

There has been much debate about the first of these and it is generally agreed that small firms face a significant finance gap that hampers start-up and growth. Part of the problem is the preference of banks to provide short term finance and to lend only against collateral. In addition, entrepreneurs often prefer to self-finance their businesses rather than take bank loans or give equity and this can lead to problems of under-capitalisation. Indeed, entrepreneurs often lack information on the range of financing options available to them or the consequences of different types of finance.

Rudy Aernoudt's chapter concentrates on this issue of improving the access of small firms to finance. He identifies the following four components of the finance gap:

- The venture gap, mainly for pure equity, focused on high potential growth, innovative and young firms.
- The risk capital gap, applying to moderate growth firms looking for equity to mezzanine financing.
- The confidence gap, related to the reluctance of bankers to make long-term loans and their preference for collateral.
- The investment readiness gap, referring to the lack of understanding by entrepreneurs of the functioning of the different sources of finance and their reluctance to go to external investors.

There are a number of levers that city and region authorities can use to address these gaps and increase private financing in their schemes to support SMEs. These include actions both to address the demand side and the supply side of SME financing. On the demand side, public sector actions are required to strengthen:

- Investor readiness. Initiatives are needed to provide entrepreneurs with information and advice on the external financing options available and on how to structure business plans to secure such finance.

- Mutual understanding between bankers and SMEs. Banks and SME organisations also need to work closely together to address the problems of both the investment readiness gap and the banker confidence gap. Cities and regions could help achieve this by supporting the setting up of round tables involving high level representatives from banks and SME organisations in order to identify the main problems in the bank/SME relationship and try to highlight a range of best practices or produce a code of conduct.

- Integrated finance. The integrated finance approach is a concept that aims to reduce the cost of finance for SMEs by analysing likely finance needs in the business plan or project and then seeking conditional offers from different finance providers against performance milestones. Venture capitalists, business angels, banks and so on can then commit in principle to an investment at a given point in a company's development with the reassurance that there will be appropriate support at each point in the project's life cycle.

On the supply side, the public sector can help to stimulate provision of finance in various ways:

- Stimulation of bank credit. Loan guarantee schemes involve the public sector providing a guarantee to a bank making SME loans against a premium paid by the borrowing party. Development agencies thus provide a guarantee of last resort. Similarly, mutual guarantee schemes involve private groupings of companies, often within the same sector, providing the guarantee of last resort for bank loans made to members. Cities and region authorities can play a role in brokering the establishment of mutual guarantee schemes.

- Guarantees to promote venture capital. City and region authorities can also guarantee the investments of venture capital funds. There are two approaches to this guarantee function. It is possible either to guarantee investments in companies or to guarantee investors in funds. An alternative is to allow private investors a fiscal deduction against losses.

- Involvement in venture capital funds. City and region authorities may also stimulate the supply of venture capital by directly financing and setting up venture capital funds in niches not already covered by the market, such as in seed and start-up risk capital.

- Business angel networks. Another method of bridging the information gap between potential investors and entrepreneurs is by setting up business angel networks, i.e. networks of former entrepreneurs who wish to invest in start-up companies and provide advice based on their own business experience. Business angel networks can function from a platform set up by a city or region using the internet, magazines or forums. Such networks give SMEs access to a new source of finance. Nonetheless it is important also to pay attention to guiding SMEs in the presentation of their projects.

- Corporate venturing. A further potential source of equity finance is large entrepreneurially-oriented companies offering both management skills and financing to small firms. Major local firms can be encouraged to participate actively in city and region seed funds and involve their executives in local business angel activity.

Thus in terms of addressing the SME finance gap, cities and regions should develop an appropriate toolbox of measures, drawing on the above instruments.

In the case of the resolving the shortage of supply of good quality and affordable accommodation for SMEs, key public sector levers include:

- Using subsidies to reduce the capital costs of development and therefore reduce rental levels.

- Engaging the planning and regulatory regime to make sites available specifically for SME premises and avoid the need for subsidy.

- Ensuring that all public sector agencies with an impact on site availability work together.

The experience in London demonstrates that good quality SME accommodation can profitably be supplied by entrepreneurial, niche property firms such as Greater London Enterprise. However, for successful public sector intervention in the provision of SME accommodation it is necessary:

- To develop an ability to work to a commercial sector timetable.

- To be pro-active in marketing existing subsidy regimes to potential developers.

- To be pro-active in making sites available, and ensuring that the use of planning and the rest of the regulatory regime works in a business-friendly way.

- To exercise political and institutional leadership such that all the public sector agencies with an impact on site availability work well together to give a high priority to creating more good quality SME accommodation.

In the field of micro-business support, the combination of very high risk and very high return potential makes it technically difficult to use leverage models that work elsewhere in the SME sector. David Walburn argues that this problem can be tackled by the use of targeted tax breaks for private sector investment in start-up/early stage investment. In the United Kingdom, the anticipated introduction of tax credits for private sector investment in deprived areas has the potential to increase leverage. This will depend on the ability of Community Development Financial Institutions (CDFIs) to devise vehicles which are attractive to commercial funds from corporate or personal sources. A further critical issue for micro enterprise support is the need to sustain the existence of good quality fund managers, to raise funds, to manage lending and to support the portfolio of enterprises which have received funding. This invariably needs some form of public subsidy to pay for the overhead costs of such fund managers.

Leveraging private finance into brownfield regeneration

Brownfields are areas of land that have been affected by their former uses, are derelict or underused, and where development may be inhibited due to the high cost of dealing with problems such as real or perceived contamination, planning restrictions, multiple ownership or risk of flooding. Thus in order to bring the private sector into a project, it is important to find ways either to reduce costs, risks and the time input implied in redevelopment or to improve returns. Following Tomerius and Ferber in Chapter 6, brownfield sites can be classified into three types, “self-developing sites”, “potential development sites” and “reserved sites” (i.e. sites without development potential for the next few years). Most effort to encourage private sector leveraging should go into “potential development sites”.

One public lever that can be used to encourage development of such sites is direct public subsidy. This can take various forms, such as grant aid, support for loans, other guarantees (e.g. income stream guarantees, support for right of first refusal on site development), and partnership projects for sharing risks and profits. Other potential levers include provision of information on market opportunities, securing commitments from various sides in terms of actions to be taken and intended uses of land, relaxation of planning restrictions, exemption of new private sector investment from the chain of liability for environmental contamination and special financial vehicles to lower risks for investors.

The United States is particularly advanced in the development of innovative practices for encouraging private investment in brownfields development, and there exist many instruments that may act as models for other countries. These are reviewed by Tomerius and Ferber in Chapter 6. The United States case is complicated by the division of responsibilities between federal, state and local levels.

At the federal level, the following key instruments are used:

- The Environmental Protection Agency's (EPA) Superfund Programme. This refers to the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). This listed highly contaminated sites and, following the "polluter pays principle", taxed the petroleum and chemical industries in order to create financial resources to defray cleanup costs from contributions by the main ground polluters. This was dubbed the "Superfund".

- EPA's pilot projects. These are pilots in different regions having access to assessment grants. These grants help to attract private investment because assessment costs are funded by public money.

- EPA's "Revolving Loan Funds". Through these funds, cities loan federal money to projects. Repayments are ploughed back into the fund and are used to support further brownfield redevelopment.

- EPA's Job Training Programme. This is focused on restoration and renovation of buildings etc, often in brownfield sites. Participating communities can recruit workers for their projects out of the training pool.

- EPA's "Showcase Communities" Programme. This gives visibility, small clean-up grants and the advantage of close co-operation with EPA.

- Tax incentives from EPA and other federal departments. These include the targeted brownfield tax expensing incentive, historic rehabilitation tax credits, low-income housing tax credits, industrial development bonds exempting certain public work facilities from taxes, tax-advantaged zones offering incentives for empowerment zones and enterprise communities.

At the state level, the following key instruments are used:

- Voluntary cleanup programmes. These are clean-up agreements with owners that work through a co-operative rather than mandatory approach.

- Liability protection for investors and developers. Liability protection is offered if requirements for site investigation and cleanup standards are met.

- Tax incentives and targeted financial assistance. These play a major role in offering convincing economic arguments for private investors to become active in brownfield deals.

At the local level, key instruments include:

- The "Community Development Block Grant Program" run by the federal Department of Housing and Urban Development (HUD) which makes low interest loans to municipalities undertaking brownfield and community development projects. These loans must be repaid by municipalities. Therefore it is of utmost importance that profitable projects are implemented in suitable forms of public-private partnership so that the loans can be paid back from increasing real estate tax revenues.

- Municipal-funded tax incentives. Examples are tax abatements, tax increment finance and the targeted designation of special service areas and taxing districts, all offering the possibility for private investors to offset brownfield redevelopment costs.

- Regular meetings or forums for public and private brownfield stakeholders.

- Remodelling of old buildings and preparing them for reuse. Planning restrictions have deliberately been kept low and buildings opened for public inspection in order to attract interest.

- Brownfield registers containing basic information about development potential, legal and technical restrictions and planning goals in the area.

- Marketing strategies highlighting the cost advantages of brownfields and the architectural charm of reusable buildings.

As well as finding the right technical instruments to encourage brownfield development it is also important to have the right conditions in place. Thus it is very important to provide both stable conditions for investment and timely decision-making on development proposals. This can often mean relaxing normal routines for planning and liability control. A good partnership between the private investors and local authorities is therefore required. The growing use of consensual instruments such as remediation and urban development contracts between investors, developers and local authorities may offer flexible ways of streamlining the complex redevelopment procedures. Tomerius and Ferber argue that it is critical to adapt the legal and funding framework to the goal of making the brownfield deal pay for both public and private developers. This should include:

- Cancelling of advantageous governmental subsidies for greenfield development and targeted financial assistance for brownfield redevelopment projects.

- Establishing a greater variety of tax incentives for private brownfield investments (e.g. tax credits, abatements and offset of assessment, clean up and remediation costs etc. – as mentioned above).

- Relaxation of legal hurdles to municipal incentives for private collaboration (such as for providing tax incentives at the municipal level).

- A greater variety of economic incentive tools for municipalities and regions to attract private investment to brownfields.

- Closer co-operation between landowners, developers and local authorities.

The potential for transfer

The discussion of policy tools in this book shows the rapid pace of change and the complexity of innovation that is underway in OECD cities and regions in the field of public-private partnership. OECD cities and regions are responding to a common challenge and much can be learned by examination of frameworks and instruments operating in different places. Clearly, however, there must always be a note of caution in discussion of the potential for transfer of policy instruments from one area to another, because what works in one context will not necessarily work in another. The information and analysis in this book are therefore put forward in the spirit of providing sources of inspiration or learning rather than ready-made solutions to import. Each city and region needs to examine the instruments that could potentially work in their area and think carefully about whether there are differences in context between originator and adopter that mean that the instrument might not work or might need to be framed differently.

This is not to say that cities and regions cannot learn enormously from what others have achieved. It is merely to add in a note of caution that such instruments may work in a certain place and a certain time for a range of reasons that are sometimes difficult to fully identify. Thus the process of policy borrowing is a delicate one, requiring much analysis, reflection and piloting, but one which ultimately has often proved very fruitful.

Greg Clark, in Chapter 8 of this book, underlines this same point, namely that each city and region starts from a different position and therefore needs a set of instruments adapted to its own situation. Among the key differences that must be borne in mind between cities and regions in different OECD countries he identifies the following eight variables:

- Fiscal and financial authority is located at different tiers within prevailing national public finance systems.

- Methods for calculating and appraising public sector debt vary across nations.

- Habits of “ring-fencing” or “hypothecating” certain public funds or fiscal tools for specific purposes are at varying degrees of being established.

- Mechanisms for attracting, appraising, and managing public/private co-investment vary significantly.

- Regimes for encouraging financial institutions to get involved in economic development vary widely.

- There are substantial variations in the extent to which public sector assets, held at the local level, are subject to regulations about their sale, re-use, or participation in a financial transaction.

- The development of single and/or free market agreements between nations has produced very distinctive outcomes in terms of parallel social and sub-national investment mechanisms.

- Political cultures vary in terms of appraising and accepting risk in relation to public sector investment in wealth creating activity and civic cultures vary in terms of how, and how much, popular support can be garnered for long term debt within lower tiers of the public sector.

Thus, there are substantial differences in what cities and regions should attempt and can achieve according to their standing on each of the above variables. The main implication is that policy learning should be done in a careful and considered manner, with due attention paid to context.

Nonetheless, there are many common trends, not least among them being the need across the OECD for more partnership working in economic development. In Chapter 7, Small and Miller identify from successful projects and initiatives in the United States, Canada, the United Kingdom and Continental Europe, certain best practices that would appear to be relevant to most cities and regions:

- Work with all affected stakeholders – government, private investors, not-for-profit organisations, local residents, and businesses – in identifying both scope and need.

- Ensure long-term economic, environmental and community sustainability, and not just fulfil immediate social needs.

- There must be strong, identifiable public and private sector leadership at the federal, state/provincial, local, community and business level.

- Adopt governance models that draw upon private sector skills and experience with the authority and financial tools to get the job done.

- Develop and use a wide array of local financial tools – grants, loans, insurance, and tax incentives. Public dollars are not sufficient. Properly designed tax incentives are essential if private dollars are to be leveraged.

- Once the community has decided on the goals and objectives, adopt a business-like approach to delivering the results. This will help reduce political interference, and give confidence to the private sector when being asked to invest.

- Design programmes with the expectations of the private sector in mind at the outset. This requires an understanding of how the private sector views risks, prevailing market conditions, financial returns, and the overall investment climate. The private sector is not geared to directly solve social needs. It can, though, be harnessed to deliver socially beneficial outcomes, provided its underlying requirements are respected and met.

- Locally administered tax incentives – Tax Increment Financing, property tax exemptions, wage credits – can be as important as national or regional level incentives. Local communities have a vested interest in making sure economic development efforts succeed. The judicious use of their taxing authority – either by local governments or their designates – to encourage private financing will ensure that measurable results are in fact achieved. Most importantly, localised financial tools depend on the success of the entire undertaking in order to provide both repayment and a return, thus sharing amongst the public and private sector the risks and rewards associated with the efforts.

Some final key messages for cities and regions seeking to develop public-private partnerships for local economic development are set out below.

Key messages for cities and regions seeking to increase private financial leverage

The main message of this book is that there are many instruments and approaches that can be applied to create successful partnerships between city and region governments and development agencies and the private sector for

economic development initiatives. In order to develop these partnerships the following points should be borne in mind by the public sector and the private sector.

The public sector

1. The public sector should recognise that there is a pressing need for reform in local financing methods. Rather than trying to act alone, public bodies can be more efficient and effective when they involve the private sector. The public sector needs to use its knowledge of the different development actors to create partnerships and to craft approaches that enable each party to do what it does best.

2. To do this properly, it must be recognised that there is currently a range of barriers and a weak incentive structure for private sector investment in local development, exacerbated by a lack of understanding of the value the private sector can obtain from building long term territorial assets. The public sector therefore needs to lead the way by being open to experimentation with different regulatory conditions and financial tools that will take away some of the costs or risks or increase the returns for the private sector. When doing this, the public sector should assess where there are appropriate leverage points at which the private sector would be willing to commit to a local economic development project, so that the public sector does not underwrite all the risk itself.

3. Tools like tax incentives can be used as long as they are targeted on genuine areas of distress and are accepted by national governments and international organisations as fair and not aimed at distorting overall markets. But there are many other development tools that could also be developed to do with land and asset management (planning gain and land swaps), revolving loan funds, guarantee systems, municipal bond issues and simple information and brokerage.

4. Cities and regions should also play a role in lobbying central government to develop appropriate infrastructure and incentive frameworks to complement their own development efforts.

5. By doing the above, the public sector can help demonstrate the existence of potentially viable markets to the private sector, certain parts of which private firms may explore in the future even without public subsidies.

The private sector

A wide variety of case examples illustrate that the private sector can make money by investing in local development projects together with public sector partners, as long as the investment is undertaken in the right way. This means taking account of the following:

1. The private sector needs to be sure that even if the public sector is taking some of the risk and initiative, the projects they support are viable and the people undertaking them are serious and committed. Thus the private sector needs to retain strong project selection methods. One simple way of judging a project, particularly where it is a small one and administrative costs would prevent a major analysis, is to ensure that entrepreneurs are themselves putting up significant resources, not just the public sector and its private sector back-up. If entrepreneurs are significantly at risk, because the bank will take their resources if the project fails, they are more likely to self-select good projects. In particular, this means that entrepreneurs should not believe that they will be bailed out by the public sector.

2. To extend this point, generally we can think of the finance for local development initiatives as falling into three risk categories. First, the highest risk money should come from entrepreneurs and developers. Second, the middle layer of money should come from public sector development agencies or the non-profit sector. Third, the least risky money should come from banks and the private sector.

3. Local development initiatives, particularly in deprived areas may need the private sector to adopt different structures than they use for other parts of their business. Private sector involvement in local development projects will need strong (i) management development, (ii) market development, (iii) product development. Doing this properly may mean creating subsidiary organisations operating at a decentralised level at arm's length from the main business, but close to the communities or issues dealt with. In

some cases firms may also benefit from working with intermediary non-profit organisations that are familiar with the problems and issues in the communities and problems concerned.

4. The private sector should think about its involvement in local economic development in terms of a long-term initiative. When getting involved in new activities firms should expect to make and learn from early mistakes. So the private sector will often be starting from a position of discomfort rather than enthusiasm. But private investors should realise that in the long-term there are gains to be had as they move up the learning curve.

In working together, it is particularly important to build long-term structures that will sustain private sector interest over time, rather than attempt to interest the private sector in a series of individual one-off transactions. Thus, each city and region authority needs to put together a toolbox of the most appropriate instruments for its area, given its powers and development needs and opportunities. These instruments should be put together as a clear package for potential investors, with appropriate contact points and marketing to back it up. A series of private investment opportunities should also be identified and prioritised for the short, medium and long terms.

Developing public-private partnerships for city and region economic development is to engage in a process of experimentation. Through this process both the private sector and the public sector need to commit to learn over the long-term in order to achieve changed mindsets. Overall, we are seeking to achieve a shift in the role of the public sector away from being a direct provider of services towards being a “market-maker”, which brings together public finance and expertise with finance and expertise from the private sector and other partners. This means that local authorities must become more entrepreneurial in their outlook and more aware of the mechanisms that can induce the private sector to take up investment opportunities. At the same time, the private sector should realise that profitable opportunities in local economic development projects can be found by working with the public sector in order to meet concerns about potentially excessive risks and costs. It is hoped that the analysis and examples provided in this book will provide inspiration to those policy makers seeking to pull together innovative packages of finance for their economic development projects.

APPENDIX
CONFERENCE PROGRAMME

Leveraging Private Finance for City and Region Economic Development
International seminar, 10.45-17.15, Wednesday 10 July 2002

hosted by
London Development Agency
OECD Local Economic and Employment Development (LEED) Programme
(Forum on Cities and Regions)
Greater London Enterprise
City of London Corporation

Venue
London Development Agency,
Devon House, 58-60 St Katherine's Way London E1

10.45-11.00	Registration *Chair: Greg Clark, Director of Strategy, Communications & Intelligence at the London Development Agency and Chairman of the OECD Forum on Cities and Regions*
11.00-11.15	Opening addresses: - Martin Baker, City of London Corporation - Sergio Arzeni, Head of the OECD LEED Programme
	Session 1: The international context and possibilities for London
11.15-11.30	Private finance for local development: an international perspective - Jonathan Potter, OECD LEED Programme
11.30-11.50	Constraints and possibilities in London - David Walburn, Chief Executive, Greater London Enterprise - Joe Docherty, Assistant Director, Barclays Bank, UK
11.50-12.00	General discussion
	Session 2: Private finance for community building
12.00-12.40	International case studies: - Sandy Braunstein, Federal Reserve Board, Washington DC, USA - Kirsten Moy, Aspen Institute, USA
12.40-13.00	General discussion
13.00-14.00	*Lunch*
	Session 3: Private finance for SME development
14.00-14.40	International case studies: - Ellen Lederman, Shorebank Advisory Services, London - Luigi Vimercati, North Milan Development Agency

14.40-15.00	General discussion
	Session 4: Private finance for brownfields development
15.00-15.40	International case studies: - Colum Halforty, Scottish Enterprise Glasgow, UK - Randy Daniels, New York Secretary of State, created the Metropolitan Revitalization Fund, USA
15.40-16.00	General discussion
16.00-16.20	*Coffee break*
	Session 5: Closing debate and remarks
16.20-17.00	Discussion led by panel from the London Private Investment Commission: - What appear to be the main success factors for public-private partnership in the case studies examined? - What conditions are required so that they can be transferred to other cities and regions? - What do OECD cities and regions need to do now?
17.00-17.15	Concluding remarks by - Sergio Arzeni, Head of the OECD LEED Programme - Greg Clark, Director of Strategy, Communications & Intelligence at the London Development Agency and Chairman of the OECD Forum on Cities and Regions

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