Property Development

Cadman's *Property Development* has long been the standard textbook on the commercial property development process in the UK, and with this new edition the book is brought completely up to date for a new generation of readers. Accessible to students of all disciplines within the built environment, the book is geared directly towards students of property development at undergraduate or graduate levels. It provides a clear and practical overview of the property development process, together with critical analysis of the key issues faced by property professionals today.

The fifth edition retains the established structure of previous editions, by focusing on land acquisition, development appraisal, finance, planning, construction, market research and promotion. Additionally, reflecting changes in practice, there is also new material on environmental impacts of property development, with a chapter on sustainable property development, and on the growth of international working in the property sector. Excellent case studies, which are enhanced by discussion questions, illustrate the process at work. This fully revised and updated edition of a classic text for all property development students will also be of interest to early career professionals and those pursuing a professional degree in the industry.

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Property Development

Fifth edition

Sara Wilkinson and Richard Reed

Foreword By Professor David Cadman

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Foreword

The first edition of *Property Development* was published some thirty years ago not long after one of those market corrections that, despite their inevitability, seem always to catch a new generation of investors and developers by surprise. Indeed, I note that as each new edition has been published, there has been plenty of evidence of the frequency of these ups and downs. Now, with the publication of this fifth edition, we are here again just as another 'unexpected' correction takes place – at least in the UK.

After thirty years and the inevitable transition from the vitality of youth to the tiring of old age, it seems fitting that the authorship of *Property Development* should now move into entirely new hands. And it is a mark of our times that the new authors of this edition should represent the global reach of commercial property markets, markets that I am told no longer have national boundaries.

This new global market is reflected in the ways in which the new authors have sought to extend the text and give new examples of practice. Indeed, it may well be that, eventually, a more assertive approach to globalisation may be needed. In time, a book that is principally about the UK may no longer meet the needs of the next generation of students as they try to come to grips with the markets that will be their working ground. For the time being, however, a focus on the UK with some useful reference to wider markets meets the needs of this book, aimed as it is at students and others that are coming to property development for the first time, and who do so principally from a UK base.

Perhaps the greatest challenge that these students will have to face – and one that we did not even have words for in 1978 – is that of sustainability and, most especially, of climate change. Indeed, it is possible that these matters will create a structural shift in markets of a kind that we have not experienced for some time. This is certainly the place to which my working life has eventually taken me and the more that I study it the greater the size of the challenge appears. Indeed, it is not all certain that we have the skills, the will or the wit to find our way through without much damage.

No longer is property development the protected zone of the landed professions. All sorts of people, now referred to as ‘stakeholders’, expect to have their say and the policies and actions of developers and investors are expected to be ‘transparent’. Property companies and institutional investors have already begun to respond. Indeed, I would say that some at least are leading the field of corporately responsible investment, with increasing evidence of well thought out sustainability policies and standards. They are also beginning to understand how to price the risks of sustainability and climate change. Perhaps this is not so surprising for, as the public sector has abandoned parts of the field that, thirty years ago, were thought to be entirely their preserve and as the private sector has taken occupation, so, too, has the level and scope of their responsibility grown so much so that responsible investment and development is now becoming the established mode.

In all previous editions of this book, I have sought to forecast what might happen next. However, all my experience of trying to foretell the future tells me that uncertainty is ever-present in property markets, the unexpected is to be expected and that, above all else, complacency is the enemy of good investment and development. I think that it is time for me to leave prediction to others. However, being wrong or right in these matters is less important than insisting upon the questions that are raised. I have often said that all forecasts are wrong, the question is: are they useful? Perhaps this should be my epitaph.

David Cadman
London, September 2007

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CHAPTER

1 Introduction

1.1 Introduction

This book introduces and details the processes involved when undertaking property development. It has been written to give the reader a thorough understanding of the nature of property development, what it involves and how to undertake a successful project. At times it is focused on UK practice, although it is truly an international text as frequently noted and commented. This is the fifth edition of the book – since the fourth edition of property development was published in 1995 there have been major changes that have affected the discipline. First, like many other areas of business activity, there has been a substantial move towards globalisation and the property development market is now undertaken on a global as well as national and local scale. For example, Real Estate Investment Trusts (REITs) have been recently introduced into the UK (KPMG, 2007), although they have been available in other global markets, and are an increasingly important source of finance for property developers. Second, the trend towards adopting sustainability within development is affecting the type of property developments perceived as desirable in the marketplace. Finally, property development processes have been significantly affected by advances in technology such as the internet (Dixon *et al*., 2005), which has speeded up the globalisation of business and allowed best practice in sustainability and property development to be communicated rapidly around the world.

The emphasis in the text is on the practical application of property development, with the reader being taken through all of the stages involved in the process, thereby providing a complete overview. In each chapter a series of discussion points are provided to prompt the reader to reflect on the content of the previous section. Furthermore, a number of illustrative case studies are included to demonstrate the application of the various development stages covered in the chapters. This text is not intended for those who already practice in this field and have experience, but as an introductory guide to students and those new to the field. It is anticipated that upon completion the reader will move onto other texts to deepen and broaden the knowledge base provided here.

The term ‘property development’ evokes many feelings depending on the particular perspective. The definition adopted in this text is that property development is ‘a process that involves changing or intensifying the use of land to produce buildings for occupation’. It is not the buying and selling of land for a profit; land is only one of the raw materials used. Others include the building materials, infrastructure, labour, finance and professional services. For the purposes of this book we are concerned with development that involves building activity for commercial use, whether carried out by the private or public sector.

Property development is an exciting and occasionally frustrating, increasingly complex activity involving the use of scarce resources. It is a high-risk activity that often involves large sums of money tied up in the production process, providing a product that is relatively indivisible and illiquid. Furthermore, the performance of an economy at national and at local levels both directly influence the process. As the development process is frequently lengthy the assumptions made at the outset may have changed dramatically by completion. Success very often depends upon attention to the detail of the process and the quality of the judgement that guides it. Success, however, cannot be judged purely by the size of the profit or loss in financial terms. As a result there are winners and losers whether measured in financial, aesthetic, emotional, social or other terms. For some it can represent an unwelcome change, replacing the familiar with heavily built-up areas fulfilling many functions. For many, however, property development is a worthwhile and very rewarding discipline.

1.2 The process

There are a variety of views on, and descriptions of, the development process. At its most simple, property development can be likened to any other industrial production process that involves the combination of various inputs in order to achieve an output or product. In the case of property development, the product is a change of land use and/or a new or altered building in a process that combines land, labour, materials and finance. However, property development is complex, often taking place over a considerable time frame. The end product is unique, either in terms of its physical characteristics and/or its location. Furthermore, no other process operates under such constant public attention.

The development process may be divided into the following main stages:

1. Initiation
2. Evaluation
3. Acquisition
4. Design and costing
5. Permissions
6. Commitment
7. Implementation
8. Let/manage/dispose

However, property development is not an entirely sequential activity and the stages in the process often overlap or repeat. The sequence is typical of a speculative development where an occupier is not sought until the building has been completed. For example, if the development is pre-sold to an occupier, then stage 8 precedes stages 2–7.

Initiation

Development is initiated when either a parcel of land or site is considered suitable for a different or more intensive use, or if demand for a particular use leads to a search for a suitable site. For the purposes of this book we will focus attention on the main uses such as shops (or retail), offices and industrial. Note many of the same principles also apply to residential developments including low or medium high-density housing in the form of a high-rise building. Often office and industrial uses are combined: buildings suitable for such uses are often defined as business space. The initiative may come from any of the actors or stakeholders in the development process seeking an appropriate site in anticipation of the demand or need for any of the above uses. Alternatively, the initiative may stem from stakeholders anticipating a potentially higher value use for an existing site due to changing demographic, economic, social, physical or other circumstances. In this case, in order to identify the most appropriate use, the initiator will seek to research the market and the potential to obtain the necessary statutory planning consent for the change of use. The roles of the various different stakeholders in initiating the process are examined under ‘Main actors’ later in this chapter. The initiator may not necessarily be involved in the rest of the development process, depending on their motive or objective.

Evaluation

One of the most important stages of the development process is evaluation as it influences the decision making of the developer throughout. Evaluation includes market research, both in general and specific terms, and the financial appraisal of the proposal (Reed, 2007). The methods of assessing the financial viability of a project are well established and are covered in Chapter 3. Historically, much less attention was given to detailed market research; however, with the application of the internet this has improved and is dealt with in Chapter 7. The process of financial evaluation needs to ensure that the cost of the development is reasonable and viable. For private sector developments, the evaluation establishes the potential for profit in relation to the risks incurred. For the public sector and non-profit-making organisations, it will attempt to ensure that the costs are recovered. An additional objective of the financial appraisal is to establish the value of the site.

This stage of the process should be undertaken prior to any commitment and while the developer retains flexibility. Though the evaluation involves the combined advice of the developer's professional team, the decision to proceed and bear the risk rests ultimately with the developer. It is a continuous process with constant monitoring, relating directly to all the other stages.

Acquisition

Once the decision to proceed is taken, there are many other decisions to be made and steps to be taken before the site can be acquired and the development started. These should include the following listed below.

Legal investigation

Unless the developer is the existing site owner all legal issues concerning the site must be assessed: this includes ownership, existing planning permissions, and any rights of way, light or support. Careful preparation is required to establish who the existing owners of all the rights to the site actually are and what will be necessary to acquire them. Any error in establishing the extent of ownership and the cost or the time in acquiring the rights to the site can seriously affect the viability of the development. The public sector may become involved in the acquisition stage, to assemble a large site with many occupiers and landowners, since they can use their legal powers of compulsory purchase. However, the use of such powers can be both time-consuming and costly. The vast majority of development is undertaken through the co-operation of the original site owners, either by disposing of their interests through negotiation or by becoming partners in the development.

Ground investigation

A thorough physical assessment of the capabilities of the site to accommodate the proposed use should be undertaken. Ground investigations involve the assessment of the site's load-bearing capacity, access and drainage. All existing services (e.g. electricity, water, gas and telephone) should be surveyed to ascertain their capacity to serve the proposed development. If the services are inadequate then the developer needs to assess the cost of their provision or expansion. The investigation should highlight the existence of underground problems such as geological faults and made-up ground, together with the presence of any archaeological remains, contamination, underground services and storage tanks. A site survey must be undertaken to establish the measurement and configuration of the site.

Finance

The developer, unless using internal resources, must also obtain appropriate finance for the development project on the most favourable terms over the entire length of the scheme, before committing to a scheme. The subject of finance will be dealt with in Chapter 4. The developer will normally be concerned with arranging two sorts of finance. Firstly, short-term finance is needed to cover costs during the development process. Secondly, long-term finance (sometimes called 'funding') will be sought to cover the cost of holding the completed development as an investment or, alternatively, to secure a buyer for the completed scheme. The level of detailed information that is required by the providers of the finance varies, but all will require convincing evidence of the ability of the developer, and the soundness of the preparation and appraisal of the scheme.

Design and costing

Design is an almost continuous process running in parallel with the various other stages, getting progressively more detailed as the development proposal increases in certainty. The developer may have detailed knowledge of what design is required if the likely occupier is known or has been secured. In the case of a speculative scheme, the developer may need to work on a number of initial ideas with the agents and the professional team before establishing a design brief for the project. The brief is particularly important for complex schemes as it sets the design parameters for the architect.

Initially, design work will be kept to the minimum to keep costs down prior to developer commitment to the scheme. However, there should be enough detail to enable the quantity surveyor to prepare an initial cost estimate; this in turn is what the developer needs to prepare the financial evaluation. In most cases this means scaled layout plans showing the position of the proposed building(s) on the site, together with simple floor plans showing the internal arrangement of the building on each floor. Plans of the main elevations of the proposed building(s), together with an outline specification of the building materials and finishes, are often desirable. These plans along with the initial cost estimate should enable the developer to prepare the initial evaluation. By the time a decision has been made to submit a detailed planning application for the proposed scheme, the initial plans will be in much greater detail. There will be a full set of plans showing the layout, elevations and section of the building, together with a detailed specification. The developer requires increasing certainty over the cost estimates to improve the quality of the financial appraisal. The quantity surveyor should be able to make a detailed estimate of the building cost at this stage to enable negotiations to commence with building contractors. Care in this preliminary work can save precious time and avoid unnecessary expenses at later stages of the development process.

The design and costing stages include all members of the professional team and continues throughout the construction of the scheme. The developer has to ensure that at each appropriate stage the design and cost estimates are complete to avoid delays to the process. In most cases the final product is very different to the initial design concept, and undergoes many design changes before the final drawings are completed. The developer has to ensure, where possible, significant, and potentially costly, design changes are minimised when the commitment stage is reached.

Permissions

Any development (with a few minor exceptions), which by statutory definition involves a change of use or a building operation, requires planning permission from the local planning authority prior to its commencement. The details of the planning process are dealt with in Chapter 5.

In many instances the developer may, where a building operation is involved, apply for an outline application before full approval is obtained. An outline planning consent establishes the approved use of the site and the permitted size or density of the proposed scheme. The developer only needs to provide sufficient information to describe adequately the type, size and form of the scheme. However, an outline planning consent, on its own, does not allow the developer to proceed with the development scheme; a further detailed planning consent is still required.

A detailed application typically involves the submission to the planning authority of detailed drawings and information on siting, means of access, design, external appearance and landscaping. It is not possible to apply for outline consent for a change of use. There may be a number of outline applications made on a particular site if circumstances change before a developer acquires the site. If the scheme changes, after detailed consent has been obtained, then further approval is required from the local planning authority.

The developer needs to make realistic initial estimates of the likely time and cost of obtaining the appropriate permission during the evaluation stage. The acquisition of planning permission can become complex, requiring detailed knowledge of the appropriate legislation and policies, as well as local knowledge of how a particular planning authority operates. The employment of 'in-house' planners by a developer or the use of planning consultants may be necessary and cost-effective where planning problems are envisaged or encountered. Where permission is refused by the local planning authority the developer may appeal to the Secretary of State.

In addition the developer may be required to enter into a contract with the local planning authority where a 'planning agreement' is negotiated as part of the planning approval. These agreements, which used to be referred to as 'planning gains', deal with matters that cannot be covered as conditions to the planning approval: the provision and maintenance of a public facilities as part of a scheme. For example, there may be improvements to adjacent roads to the site to provide safe access to the site after completion of the development. Planning agreements must be signed before approval is granted and often impose additional development costs, therefore affecting the overall evaluation of the scheme.

In some circumstances there are a variety of other legal consents that may be required prior to commencement of a development. These include listed building consent (the right to alter or demolish a 'protected' or landmark building); the diversion or closure of a right of way; agreements to secure the provision of the necessary services and infrastructure; and, in all cases where building operations are involved, building regulation approval. The prudent developer must clear all legal permission hurdles before making a commitment to the development.

Commitment

A developer must be satisfied that all the necessary preliminary work has been undertaken before any substantial commitment is made in relation to the development. Ideally all the appropriate inputs of land, finance, labour and materials, and the acquisition of statutory permissions must be satisfactorily negotiated before any agreements are signed making the developer liable for any major outlay of money. When the preliminary work has been completed as far as possible, the project must be evaluated once again. This is because it may be that the preparation of the scheme has taken some time and the economic circumstances that determine the success of the development have changed. It is vital, therefore, that the developer pauses for thought until absolutely satisfied that the evaluation is based on the best possible information and the scheme is still viable.

Until the land is acquired, the developer must keep costs to a minimum. The likely costs up to this stage are professional fees and staff time. Depending on individual circumstances some of the professional team may be willing to work on a speculative basis or at reduced fee in order to secure full appointment once the scheme commences. In some cases the developer may be acquiring the land without the benefit of planning permission and, therefore, the contract may be made subject to obtaining the necessary planning approval. In addition, conditional contracts to acquire a site are often entered into when either the developer has had insufficient time to carry out all the important preliminary investigations, or alternatively the developer is yet to secure the necessary finance.

At some point in time all of the contracts to acquire the land, secure the finance and appoint the building contractor together with the professional team will be signed. These contracts may not necessarily be signed together; the developer must aim to achieve this as profits will be maximised. In the case of a non-profit development, ensuring that the commitment is held back until all the resources are in place will minimise cost and risk.

Implementation

The implementation stage can commence once all the raw materials of the development process are in place. At this point there is a commitment to a particular site and to particular buildings at a particular cost spread over a particular time. However, the flexibility, which was previously possible in the earlier phases, has gone. What needs to be emphasised is *the importance of careful evaluation and of maintaining flexibility* as long as possible.

Throughout this stage the underlying goal, and this aspect is often challenging, is to make certain the development is completed within both the time and budget stated in the evaluation, without comprising quality. Depending on the experience of the developer and the complexity of the scheme, this may best be achieved by employing a project manager to co-ordinate the design and building process. The project manager and/or developer must anticipate problems and make prompt informed decisions to minimise delays and extra costs. Furthermore, the developer must take as much interest in the running of the project as in its promotion and the market must be monitored continuously to ensure that the product is right, which may result in amendments to the specification. Where a non-profit development is concerned, the developer must aim to contain costs, while maximising the benefits of occupation. The construction and project management stage of the development process is covered in Chapter 6.

Let/manage/dispose

Although this phase of development occurs often at the latter stages, it must be at the forefront of the developer's thoughts from the initiation of the scheme. In some cases the occupier may have been secured at the start or during the development process. The development's success will depend on the ability to secure a willing occupier at the estimated rent or price, as well as within the period originally forecast in the evaluation. The disposal may take the form of a letting or it may be the outright sale of the freehold interest. In the case of a major retail development there are many lettings, while in that of a single office building the property may be disposed of in one major letting.

It is at the evaluation stage that the letting and/or sales strategy should be thought out, and then subsequently updated, where possible and appropriate, during the course of the development. As such any agent or a member of staff employed by the developer to secure lettings/sales should be included in the development from the beginning of the process. In addition a decision must be made at what point it would be sensible to let or sell the scheme. In many cases it is necessary to complete or virtually complete the development before seeking an occupier. This decision may not be the developer's alone and may be heavily influenced by other actors in the process such as the financiers or the landowner (if they have remained a partner in the development).

At the start of the process the developer has to decide whether the property investment created is to be held as such or sold to realise any profit, unless it has been pre-sold to the long-term financier of the scheme. Such a decision is dependent on the motivation of the developer as well as the prevailing property investment market conditions at the time. However, developers have to be flexible to accommodate any changes in the investment market prior to completion of the scheme. This means that careful thought needs to be given to the investment value at the initial evaluation and design stages. Therefore, if the decision is made to sell the investment to an investor, then the developer needs to fully research their requirements. The location, specification and financial strength of the tenant(s) will be critical in achieving the best price for the investment. The developer may employ an agent to secure a sale of the property to an investor. The agent should be employed as early as possible to advise on the optimal specification and design of the property development scheme.

In accordance with best practice, the development process and the developer's responsibility should not cease with the occupation of the building. There is still a need for the developer to maintain contact with the occupier, even though no direct landlord/tenant relationship may exist. This is because developers can learn more about occupiers' requirements in general and, in particular, the shortcomings of the completed building from a management point of view. Therefore, management needs to be considered as part of the design process at an early stage if the final product is to benefit the occupier and earn the developer a good reputation. The financial success of the development cannot be assessed until the building is complete, let and, where appropriate, sold. Often it may not be until the first rent review under the terms of the letting (typically 5 years after occupation) that the overall picture will become clear.

Discussion point

How do the different stages in the property development process relate to each other?

1.3 Main actors

The development process has been divided into stages and reviewed above. Within each stage, and across some or all of them, there are a variety of important actors who each contributes to the outcome of the property development process and who may have very different perspectives and expectations. The role of the developer has been compared with that of a director of a play who has to manage the diverse and conflicting objectives of all actors on a public stage. As such a director must have the capacity and energy to pull together the performance to ensure it reaches a satisfactory solution.

The actors are considered below in approximately the order they appear in the development process. It is noted, however, that their importance varies from project to project and not all of them appear in every development scheme.

Landowners

Landowners play an important role, whether actively or passively. For example, they may actively initiate development by a desire to sell and/or improve the value of their land. If they are not the active initiators, it may be the case that they become a crucial hurdle to the development, for without their willingness to sell their interest or participate in the development (unless compulsory purchase powers are used), no development can take place. Also the landowner's motivation may well affect their decision to release land for development, and this is the case whether they are individuals, corporations, public authorities or charities. At times they may even take on the role of the developer, either in whole or in part.

Land ownership has been categorised into three broad categories, namely traditional, industrial and financial, as summarised below.

1. Traditional landowners include the church, landed aristocracy and gentry, and the Crown Estate. As such these are significant owners in terms of area and capital value. One of their distinguishing characteristics from other categories is that they are not entirely motivated by the economic imperative. The motives for ownership are wider than return on capital and involve social, political and ideological constraints.
2. Industrial landowners own land incidental to their main purpose, which is some form of production or service provision. This category includes a wide variety of types, including farmers, manufacturers, industrialists, extractive industries, retailers and a variety of service industries. Public authorities of all types, such as centralised and local groups who own land incidental to providing a service or product, might also be included in this category. Consequently the motives of this group are complex, in that they are both dominated and constrained in their attitude to land by their main reason for existence – their product. Furthermore, they may be constrained by their legal status and, therefore, will not always be seeking to maximise their return on land or property in the narrow sense, since that would be seen as subservient to their main purpose. Thus for

them, the economic advantages of releasing land for development are not always evident. If they are forced to sell their land due to a compulsory purchase order, then although they are compensated for the costs of relocating and the disturbance to their business, no allowance is made for the fact that they are unwilling sellers (unless they are residential occupiers). There are intangible losses to commercial businesses that are difficult to value.

3. Financial landowners see their ownership as an investment like any other and may, therefore, be expected to co-operate with development if the return on their land is financially optimal. This category of owners has clear financial motives and is likely to be the most informed type of owner regarding land values and the development process. The major group in this category are financial institutions (pension funds and insurance companies) who own a significant proportion of land by capital value and have been investing varying percentages of their considerable funds in property investment. They may also act as developers directly, or in partnership with developers. Also included are the major property companies who own substantial portfolios of properties and carry out development, and who may, therefore, act as both landowner and developer (see below).

Historically some landowners have had a substantial impact on the spatial layout and the type of development constructed, for example the Grosvenor and Bedford estates in London. Nowadays the planning system has lessened the impact they are able to have on the type of development, but they can still influence the location and planning. The number of owners involved in any particular development also has an important effect, as the greater the number of owners and the smaller their holdings, the more difficult it is to assemble a development site. Many developments have taken years to come to fruition, requiring great patience on the part of the developers.

Developers

Private sector development companies come in a variety of forms and sizes ranging from one-man bands up to multinationals. Their purpose is usually clear: to make a direct financial profit from the process of development – in the same way that any other private sector company operates, whatever their product.

Developers operate primarily as either traders or investors. Most small companies have to trade, that is to sell the properties they develop, as they do not have the capital resources to be able to retain their completed schemes. Many larger public quoted development companies (often referred to as merchant developers) have preferred to trade developments to capitalise on rising rents and values. However, such a strategy can have flaws – for example, in the 1980s many borrowed money on the strength of their future profits and most went into receivership during the financial crash of the early 1990s, the reason being that their limited assets were insufficient to support them. Although some survived, they were effectively controlled by their bankers. Many trader–developers seek to evolve into investor–developers as success enables them to retain profits for investment purposes. At the other end of the scale, some of the largest companies – in terms of capital assets – engage in hardly any new development at all, being content to manage their property portfolio and undertake predominantly refurbishment and redevelopment work. Residential developers operate almost solely as traders as the market is heavily biased towards owner occupation, although many often become significant landowners during the development process.

It also follows that the kind of development undertaken varies considerably. For example, some companies will specialise in a particular type of development, such as offices or retail, and also in particular geographical locations; on the other hand some property developers prefer to spread their risk across types and locations and countries. Some remain in a specialist type of development but cover a wide geographical, and possibly even an international, area. Property companies formulate their policy according to the interest and expertise of their directors and their perception of the prevailing market conditions.

Public sector and government agencies

As a result of central government policy the UK public sector currently undertakes relatively little direct development. Local authorities are primarily involved with developments for their own occupation or community use and the provision of infrastructure. Local authorities are both constrained by their financial resources and limited by their legal powers. Furthermore, local authorities have to be publicly accountable and are obliged to have regard to the overall needs of the community they serve. Local authority involvement in the development process will depend on whether they wish to encourage development or control development in order to maintain standards. Many local authorities undertake economic development activities, with the limited resources they have to promote development and investment in their area. Many active authorities act as a catalyst to the development process by supplying land, and where possible buildings, to achieve economic development of their area. Participation may be limited to the role of landowner in maintaining a long-term interest in a development. Local authorities will often retain the freehold of their development sites and grant a long leasehold interest to the developer, then share in rental growth through the ground rent.

Previously UK government policy was promulgated on the basis of only intervening in the development process where private market forces failed to bring forward development, particularly in areas targeted for economic development. The government's urban regeneration initiatives are administered through several government agencies including Urban Development Corporations (UDCs), English Partnerships, the Welsh Development Agency and Scottish Enterprise. Their role is seen as an enabling role, bringing forward development and attracting investment, in partnership with the private sector. They are able to assist developers with land assembly, site reclamation, the provision of infrastructure, financial grants and, more recently, rental guarantees, following the relaxation of Treasury rules. Other government initiatives aimed at attracting occupiers with financial incentives to specific areas of the country include Enterprise Zones and Regional Selective Assistance. UK government initiatives on urban regeneration are covered in Chapter 2.

Planners

The UK planning system has existed in a comprehensive form since 1947 and is firmly established as the major regulator of property development (see Chapter 5 for a detailed account). Planners can be divided into two broad categories: politicians and professionals. The politicians, usually on the advice of their professional employees, are responsible for approving the development plans drawn up by professionals in accordance with government policy. They are also responsible for determining whether applications for permission for development proposals should be approved or refused. The professionals are responsible for advising the politicians and administering the system.

The main purpose of planning is to 'encourage development' and to prevent 'undesirable development'. The basis for determining planning applications is laid down by statute and a variety of central government policy guidance notes. Local government must adhere to these and determine its own local policy through the main medium of development plans. Individual planning applications are determined in the light of these development plans, written government policy and advice, previous decisions and the particular nature of the application. Nevertheless often in practice there are many gaps and conflicts in the guidance, which means that developers often employ planning consultants to assist them in negotiations with planners. Developers need to know what use, what density and what design standards are required in order to obtain permission. A successful application is usually best achieved by prior negotiation with the authorities and this may involve agreement by the developer to provide infrastructure or community facilities in the case of a large development, known as a 'planning agreement'. This type of agreement is endorsed by government guidance provided it reasonably relates to the development proposed. In the context of tight public spending controls, a planning agreement is seen by local authorities as a means of securing useful benefits for the community. However, the issue of planning agreements has been controversial and there is a limit as to how much a developer can afford and so a test of 'reasonableness' is usually applied to applications.

Planning authorities differ widely in their policies towards development. Those in areas of low economic activity typically wish to encourage development activity, putting only minimal restrictions on proposals, particularly those that will provide employment. Authorities in areas of high economic activity mainly see their role as imposing higher standards, and even slowing down development in order to achieve a better balance of uses and improved design of buildings. In this situation there is an increased level of conflict between developers and planners, leading to increased use of the appeals system, especially in areas of high economic activity. In some instances the conflict is caused by the politicians ignoring the advice of the professionals.

Financial institutions

Unless a development is being financed entirely with a developer's own capital or that of a partner, then financial institutions, as providers of finance, have a very important role in the development process. Financial institution is a term usually used to describe pension funds and insurance companies. However, there are many other financial intermediaries such as clearing and merchant banks (both UK and international), as well as building societies who also provide finance for property development.

There are two main types of money required for development: short-term money, also known as 'development finance', to cover the costs during the development process; and the long-term money, or 'funding', to cover the cost of holding the completed development as an investment. Alternatively, the developer will in the long term seek a buyer for the completed scheme to repay the short-term loan and realise any profit.

Financial institutions (pension funds and insurance companies) are motivated by direct financial gain. However, unlike developers, they take a long-term view, needing to achieve capital growth to meet their payment obligations in real terms to pensioners and policyholders. Note that pension, life and investment funds are usually judged on their short-term performance, both in relation to other forms of investment and to the returns they achieve against competing funds. They seek to minimise risk and maximise future yields. The yield on any investment is the annual income received from the asset expressed as a percentage of its capital cost or value. Property or real estate is only one of a number of investments the institutions invest in and may represent only 5–15 per cent of their entire portfolio of investments. In the case of property the financial institution will receive a lower initial income when compared to a fixed-interest investment, but this will be more than compensated by the long-term growth.

Both short-term and long-term finance may be provided to a developer by what is called 'forward-funding' a development; in other words they agree to purchase the development on completion whilst providing all the finance in the interim. Almost all of the risk passes to the developer who will in most cases provide a financial guarantee. Alternatively, they may act as developer themselves to create an investment: all the risk is theirs but they do not have to provide a profit to the developer. Some only purchase completed and fully let developments since they perceive the overall development as being too risky. In order to be persuaded to take on the risks associated with development, rather than purchasing a completed and let scheme, they need a higher return or yield.

Whether acting as developer, financier or investor they tend to adopt rigid and conservative policies, although they all differ in their individual criteria. However, they all tend to seek a balanced portfolio of property types rather than specialising in one particular use. Most try to spread their investments geographically. They will seek properties or developments that fit their specific criteria in terms of location, quality of building and tenant covenant (i.e. financial strength). As a result developers sometimes lean towards to developing schemes in accordance with the financial institutions' specification rather than that of the occupiers. Financial institutions wish to purchase a building that has the widest tenant appeal, consequently their advisers may take a conservative view and recommend the highest specification, which can lead to less sustainable and over-specified buildings.

The developer may approach the banking sector for funding if a development is either not 'institutionally acceptable' or if the developer is not prepared or is unable to provide the necessary guarantees. Alternatively, the developer may prefer to use debt finance in a period of rising rents and values to maximise the potential profit on completion. There are a great variety of methods of obtaining finance from the banks both for short- and medium-term finance (these are covered in detail in Chapter 4). The banks also aim to make a financial profit from the business of lending money. Bank lending may take the form of 'corporate' lending to the development company or lending against a particular development project. The banks will use the property assets of the company or the property as security for the loan. Property is attractive as security as it is a large identifiable asset with a resale value. Banks wish to ensure that the proposed development is well located, the developer has the ability to complete the project and the scheme is viable. With corporate lending the bank is concerned with the strength of the company, its assets, profits and cash flow. Depending on the size of the loan, and in particular where the bank is exposed to above normal risk, then the banks may secure an equity stake in the scheme.

Residential developers who build housing for owner-occupation only require short-term development finance, which is usually provided by the banks. Their ability to raise finance is based on their 'track record' and the value of the scheme.

For public sector development, the sources are similar but much more difficult to obtain, primarily due to tight central government control on public sector borrowing. Some local authorities may obtain funding through grants for urban regeneration projects in specific geographic areas, mainly from central government sources and European Structural funds. However, access to such funding is subject to competition and targeted at schemes carried out in partnership with the private sector and the community.

Developers may also obtain financial assistance from the various government agencies in the form of grants, rental guarantees and equity participation through the provision of land. However, the developer has to prove that the project would not proceed without such assistance and, importantly, that it will create jobs relevant to the local population.

Building contractors

Building contractors are employed by developers to construct the development scheme and their prime objective is direct financial gain. There are a great many building contractors and a considerable variety of contractual systems for obtaining a completed building (see Chapter 6 for a detailed account).

Some development companies employ their own contractors. Residential developers tend to employ all the necessary expertise in-house: this is why they are often referred to as house-builders. Development companies may keep their contracting division at ‘arm’s length’ as an entirely separate profit-making centre though there is a general trend towards a more integrated approach. A builder who takes on the role of developer, e.g. house-builder, also takes on the additional risk associated with the development process. When a builder is merely employed as a contractor the financial profit is related to the building cost and length of contract. Under a ‘design and build’ type of contract a contractor will take on a design role that will involve a greater element of risk in relation to the responsibility for cost increases. Larger contractors with the relevant expertise may take on the role of a management contractor and manage all the various subcontracts for the developer in return for a fee. In the case where the builder is the developer, then a larger return is required due to the risk involved, but by combining the building and development profit an overall lower profit is acceptable. For builders who employ a substantial labour force, an additional objective may be to ensure continuing employment. Sometimes this can only be achieved by cutting tender price, leading, therefore, to decreased profits.

Essentially, building contractors carry out a specialist activity within the development process, commencing at a time of maximum commitment and risk for the developer. The prudent developer will, therefore, ensure the capability and capacity of the contractor(s) to undertake the proposed work, seeking the right balance between the lowest tender and quality of performance. However, it is not in the contractor’s or developer’s interest to have a situation where the contractor is unable to make a reasonable profit from the scheme. Clearly it is not in the developer’s interest for the contractor to go bankrupt or to be compromising on quality.

Finally there has been a major change in the way public infrastructure can be delivered in the UK. Public Private Partnerships (PPPs) are a key component of the UK government’s strategy. PPPs are developed with three objectives:

1. to deliver significantly improved public services, by contributing to increases in the quality and quantity of investment;
2. to release the full potential of public sector assets to provide value for the tax payer and wider benefits for the economy;
3. to allow stakeholders such as the users of the service, taxpayers and employees to receive a fair share of the benefits of the PPP.

For mutual benefit, PPPs bring together a public body and a private company in a long-term joint venture for the delivery of high-quality public services. The UK government has realised that the public sector cannot always deliver major investment projects, although the private sector may bring about benefits including:

- increased efficiency and the increase in innovative ways of delivering public services;
- motivation to invest in high-quality assets to optimise maintenance and running costs;
- improved management of the risks involved in completing complex investment projects to time and budget, and providing quality services thereafter.

Drawing on the best of the public and private sectors, PPPs provide additional resources for investment in public sectors and the efficient management of that investment. PPPs cover a wide range of different types of contractual and collaborative partnerships, such as the Private Finance Initiative (PFI), the introduction of private sector ownership into state-owned businesses, the sale of government services into wider markets and the generation of commercial activities from public sector assets through, for example, the 'Wider Markets Initiative'.

Agents

Commercial agents, or estate agents where residential developments are concerned, may be instrumental in initiating the development process and/or bringing together some of the main actors in the process. They also form the link between the developer and the occupier, unless the developer uses in-house staff to perform the agent's role; in this case the occupier is not represented by an agent. Therefore, they play a very important role within the development process and are often involved in every stage of the process. Agents are able to perform this role due to their detailed knowledge of both the property market in terms of demand and current rents/prices, relying upon their 'personal' contacts with developers, occupiers, financial institutions and landowners. This emphasises the fact that the development industry is primarily all about 'people'.

The agent's aim is to make a direct financial profit from the fees charged to their client (be it the developer or occupier) for carrying out a professional service. In the case of introducing one party to another they only receive a fee if the transaction is completed (e.g. the property is let) but it is nearly always related to the value of the transaction in percentage terms. They may be instrumental in initiating the development process, either by finding a suitable site for a developer or advising a landowner to sell a particular site due to its development potential. Unless they are retained by a developer to specifically find sites to suit a particular use, they take the initiative in identifying suitable sites and 'introduce' them to developers. In addition they will introduce sites to those developers who they consider have the appropriate expertise and resources to both acquire the site and complete the development. The agent will negotiate with the landowner on the developer's behalf and then advise the developer on all matters relating to the evaluation stage. In return they may secure not only a fee for introducing the site (usually related to the purchase price) if the acquisition stage proceeds, but they may also secure appointment as post-completion letting and/or funding agent for the development scheme. Even though it can often be a lengthy and time-consuming process for the agent, the rewards can be high. If an agent acts for a landowner then they advise on both the likely achievable land value and the likely market for the site.

Agents may be used by developers to assist them in securing the necessary finance for a development scheme due to their knowledge of the requirements of the financial institutions or banks. Furthermore, many institutions retain agents to advise them generally on their property investments including development funding: they may specifically find development opportunities for their client to fund. The institution's agent will normally advise their client throughout the process and be one of the letting agents on the scheme. Some of the larger or more specialist firms of chartered surveyors, with financial service divisions, may act as financial intermediaries arranging funding packages with banks and other institutions in return for a fee related to the size of the loan.

Agents are widely employed by developers as letting or selling agents, where they provide that all important link between developer and occupier. In performing this role they should be involved from the start of the development to enable them to advise the developer on the occupier's viewpoint. However, unless they have a specialist marketing department they usually cannot give total comprehensive advice on the precise requirements of the market. A developer will need to commission market research to obtain more detailed knowledge of the specific market for the completed development. Some developers may employ an in-house team, although the advantage of the agent is their knowledge of the market in general and their contacts with potential occupiers or their agents.

Developers, landowners, occupiers, financiers and property investors may at some stage in the development process employ a suitably experienced qualified chartered surveyor or valuer to undertake professional work to assist their decision-making process. Chartered surveyors and valuers are employed by the vast majority of commercial and residential agents to enable them to undertake professional work alongside their agency work. Professional work that is related to development may include valuation, building surveys and management. Developers will require an independent valuation to check their own opinion of value, particularly where they have insufficient knowledge themselves or it is required by a financier of the development. Independent and in-house valuers are also used by financial institutions and banks on schemes for which they are considering making loans or granting mortgages, including the asset value of any security being provided by the developer. Financiers will often employ building surveyors to check on the construction phase of the development to ensure that it is being built to the right specification, as well as to certify drawdown of the development loan. In the public sector, local authorities, central government and the Inland Revenue all use valuers to advise and check on any development-related work.

Professional team

The development process is complex and, therefore, the majority of developers do not have the skills or expertise to carry out a major development. As a result, developers employ a range of professionals to advise them at various stages of the development process depending on their needs; these include the following listed below.

Planning consultants

Planning consultants negotiate with local planning authorities to obtain the most valuable permission for a development, particularly with large or sensitive schemes. If a planning application is refused they will be employed to act as expert witnesses in presenting the case for the developer. Furthermore, planning consultants can advise landowners to ensure that the sites within their ownership that are allocated under the development plan are aligned to their most appropriate or valuable use. This may involve negotiations with the local planning authority at plan preparation stage, or subsequent representations at an inquiry into the development plan. In performing this role the planning consultants can be important initiators of the development process.

Property economics consultants/valuation surveyors

Property economic consultants or valuation surveyors are employed at the critical evaluation stage to provide a detailed analysis of the characteristics of the market in terms of the underlying demand and competitive supply. Many financiers, particularly the financial institutions, insist on market analysis when considering a development funding proposal. In addition, they often employ researchers in-house in formulating their funding criteria and policy (see Chapter 7 for further details on the use of research).

Architects

Architects are employed by developers to design the appearance and construction of new buildings or the refurbishment of existing buildings. They may also administer the building contract on behalf of the developer and certify completion of the building work. In the case of refurbishment work, building surveyors are usually employed to survey the existing building and advise on the alterations and provide contract administrations services. Architects are normally responsible for obtaining planning permission where a planning consultant is not employed. With a refurbishment the building surveyor will perform this task. Architects are normally paid on a ‘fee’ basis, usually a percentage of the total building contract sum.

It is important that the architect is employed at the earliest possible stage to ensure that all design work is ready when construction is due to commence. It is also important to employ architects with the appropriate experience, reputation, resources and track record. A developer should ensure the architect has the right balance of skills to produce not only good architecture, but also a cost-effective and workable design attractive to occupiers. This balance is very often hard to achieve and, therefore, it is important for a developer to produce a clear architectural brief from the start. Problems start when there is insufficient communication between architect and client.

Some firms of architects offer a comprehensive service, including project management, engineering and interior design work. This may be effective on some development schemes but most developers tend to prefer to assemble their own professional teams to achieve the most effective and experienced team. Some development companies, particularly those which specialise, employ in-house architects and design professionals.

Construction economists or quantity surveyors

Construction economists or quantity surveyors are, in simple terms, 'building accountants' who advise the developer on the likely costs of the total building contract and its associated costs. Their role can include costing the designs produced by the architect, administering the building contract tender, advising on the most appropriate form of building contract (procurement), monitoring the construction and approving stage payments to the contractor. They are increasingly becoming involved in the administration and management of design and build contracts. Like architects, their fee is based on a percentage of the final contract sum. The choice of quantity surveyor should be based on appropriate experience and reputation. Importantly, the developer should select a quantity surveyor who works well in partnership with architects and other members of the professional team to produce cost-effective designs. Also, a good quantity surveyor should be able to provide the developer with cost-effective ideas as alternatives to those proposed by the architect.

Engineers

Structural engineers are employed to work with the architect and quantity surveyor to advise on the design of the structural elements of the building. They will also participate in the supervision of the construction of the structure. Civil engineers will be employed where major infrastructure works and/or ground work is required. On large and complex schemes, often mechanical and electrical engineers are used to design all the services within the building. Engineers are usually paid a percentage fee based on the value of their element of the building contract.

Project managers

Project managers are employed to manage the professional team and the building contract on behalf of the developer. Project managers are normally only employed on the larger and more complicated schemes. They often come from other built environment professions – for example they may have been educated and trained as a quantity surveyor or civil engineer or architect initially.

Developers often act as project manager or rely on in-house staff or another member of the professional team. They should be appointed before any of the other professional team or the contractor so that they are in a position to advise the developer on the best professional team for the project. Their fees are normally based on a percentage of the building contract sum, but often there may be an incentive for managing the scheme within budget and on time. Developers often perform the role of project managers themselves for occupiers who wish to employ the expertise of a developer in constructing their own premises.

Solicitors

Solicitors are needed at various stages throughout the development process, starting with the acquisition of the development site through to the completion of leases and contracts of sale. They are often involved with the legal agreements covering the funding arrangements entered into by the developer. If the developer has to appeal on a planning application then both solicitors and barristers may be involved in presenting the developer's case at an inquiry. With some schemes collateral warranties are required by purchasers and the solicitors will be involved in this process. Collateral warranties are defined as agreements under which parties with contractual obligations, in connection with construction or operation of a project, accept liability to the lenders for their performance.

Accountants

In some cases specialist accountants may be employed to provide advice on the complexity of tax and Value Added Tax (VAT) regulations that can have a major cost impact on a development. They may also provide advice on the structure of partnership or financing arrangements.

Note that the above is not intended as an exhaustive or detailed list of the various professionals and specialists employed during the development process or their professional expertise or their roles. However, it is designed to give an insight into the main professional support. There are a considerable variety of other specialists who may be necessary depending on the circumstances of the project and its complexity. For instance, other relevant professionals may include highway engineers, landscape architects, land surveyors, soil specialists, archaeologists, public relations consultants and marketing consultants. Hence the above shows the variety of skills that are required within the development process.

Objectors

There are two categories of objectors who can potentially cause delay and possible abandonment of development projects. The first may be purely 'amateurs' and self-interested neighbours of the proposed development.

They are sometimes referred to as 'NIMBYS' ('not in my back yard') and, where organised, they can achieve considerable obstruction to the progress of development proposals. For example, in the past such well-organised and influential organisations contributed towards the abandonment of proposals for private sector new towns in Oxfordshire and Hampshire.

The second category is the well-organised professional, permanent bodies at local and national level. Locally they include amenity societies who take an interest in every proposal affecting their local environment and heritage. Nationally they include the Victorian and Georgian societies. These bodies have considerable influence with the local planning authorities and tend to always be consulted on major applications. There are also official quangos (quasi non-government organisations), such as the Royal Art Commission, the Nature Conservancy Council and English Heritage, who may take an interest in important buildings and existing flora and fauna. These organisations are well informed and have a good knowledge of the planning and development processes.

Finally, another organised group that emerged during the 1990s were the environmental activists. To date their activities have been focused on larger developments. During the early 1990s environmentalists occupied the Twyford Down section of the M3 extension in Hampshire causing major delays and unwanted media attention to the project. Such protests are not confined to the UK and occur in other countries such as the Three Gorges Project in China or the Tehran–Shomal (Northern Iran) highway. The protests can take the form of direct action such as occupation, or a more passive approach such as letter writing to officials.

Developers must be aware of their interest (or likely interest) and be prepared to accommodate or refute their opposition. Ideally such negotiations should be carried out before a planning application is made to avoid lengthy delays. Opposition can be costly to a developer, either by imposing higher standards and costly alterations or lengthy delays. At worst, opposition can lead to the complete abandonment of proposals that may have been sound. Prudent developers need to account for objectors when evaluating their proposals.

Occupiers

Unless the occupier of a building is the developer or is known early in the process, then the occupier is not regarded as a main actor within the development process as they are often unknown until the development is complete and let/sold. Their demand for accommodation triggers the development process and influences both land prices and rents, to which developers respond (see ‘Economic context’). The occupier is an actor within the process and their requirements should be researched at the beginning of the process. Developers in the past have tended to produce buildings in accordance with the requirements of the financial institutions and the needs of the occupier have been overlooked. However, there is a growing recognition within the industry that this has to change and many developers now commission research into occupiers’ requirements at a general and specific level (see Chapters 7 and 9).

Of course when the occupier of the scheme is known early on, then the occupier becomes the most significant actor in the process. The building will be constructed in accordance with the occupier’s requirements, which can be very specialised, particularly with industrial users. The developer may need to persuade the occupier to compromise on their requirements to provide a more standard and flexible type of building, so that the investment market for the building is wider in the event of disposal. The developer will also be concerned to protect the value of the building as security for loan purposes.

Occupiers, as commercial businesses, largely tend to regard the buildings they occupy as an overhead incidental to their activities as providers of a service or product. Although some companies do employ an in-house property team (consisting of surveyors and facilities managers) and many are set up as a profit-making centre, in some instances acting as consultants to other occupiers (e.g. Digital’s facilities management consultancy), many occupiers tend to fail to adequately plan their property requirements far enough in advance. They simply react to changes in their business as they happen. The property requirements of occupiers are influenced by both the short-term business cycle and long-term structural changes underlying the general economy (see ‘Economic context’ and Chapter 7). Either of these factors may influence occupiers at a specific level or across the business sector in which they operate. Their demand for accommodation is also influenced by advances in technology affecting both working practices and their physical property requirements.

Both agents and developers criticise occupiers for not knowing what they want, although many companies are becoming far more knowledgeable about the role of property within their businesses and their requirements in terms of specification. This is evidenced by the expanding profession of facility management. Occupiers have differing requirements and priorities, particularly in the case of offices, making the task of the developer difficult in producing a building suitable for as many tenants as possible. The response of the financial institutions is to seek the highest quality specification with a layout to suit the widest possible range of tenants. As a consequence an occupier may be forced to occupy a building that compromises their requirements in terms of location or specification. There have been many examples of occupiers stripping out buildings and refitting them in accordance with their requirements. For example, it is impossible to achieve a multipurpose building, say in the City of London, where financial service companies require large open plan floors with high ceilings and professional services companies require cellular offices with good natural daylight.

A further area of conflict between occupiers and the financial institutions concerns lease terms. Depending on the local market conditions of supply and demand, occupiers are demanding more flexible lease terms to enable them to respond in the short term to their property requirements. Although gradually changing, many financial institutions prefer the traditional 25-year lease term with upward-only rent reviews. However, many will accept shorter lease terms (from 15 years) and options to break if the market conditions require such agreements. In countries other than the UK is it common to find quite different lease terms, for instance in the US where 5-year leases with an option to renew for another 5-year term is the 'norm' for commercial office space.

Developers and the financial institutions are taking more account of the needs of occupiers. There is recognition that the office buildings of the 1980s were over-specified and that reducing the costs of occupying a building are important to occupiers. Note that the British Council for Offices (BCO) has published guidelines for best practice for office buildings. The trend is towards energy efficient buildings with the maximum use of natural ventilation and the use of air conditioning only where absolutely essential (see Chapter 9).

Discussion points

Who are the main actors in the property development process?
For a large-scale, out-of-town retail development who do you think would need to be part of the developer's team and why?

1.4 Economic context

Property development does not, of course, occur in a vacuum. Occupier demand is a reflection of the short-term and long-term changes in the economy. Availability of development finance is also linked to conditions in the wider economy. The economic context is important to developers in both a specific way (in so far as the local economic context helps to determine the market for an individual scheme) and in a more general way via the wider economy (as it affects general property market conditions and the confidence of occupiers, investors and developers).

The local economy

However, local economies are vitally important and research studies show that most demand for an individual office or industrial development is drawn from a small geographical area around the scheme. Similarly, the ability of a retail scheme to attract national retailers depends crucially on the spending capacity of the local population. Since local economic conditions will help determine how much development, and of what type, is appropriate in a particular place, it is in the interest of any developer to look beyond the individual scheme to the wider economy. The local economic context can thus be a useful indicator of the likely viability of any development project, and can be used alongside the development appraisal. The role of market research is covered in Chapter 7.

The national economy

At a more general level, the interaction of the short-run business cycle with property cycles creates great variability in a developer's plans, and the ability to progress schemes at different times. The developer also needs to be responsive to the more evolutionary changes that occur in occupier preferences as a result of long-term changes in the structure of the economy.

The business cycle

Economic and property research has established the nature of the link between the economic, or business, cycle and the property market. Useful early references on this complex topic include the report and papers on building cycles by Richard Barras (1994) and reports from the Royal Institution of Chartered Surveyors on property cycles, carried out by the University of Aberdeen and the Investment Property Databank (1994). Three important cycles were identified, all of which exhibit different periodicity – the business cycle (which drives the occupier market), the credit cycle (which influences bank and institutional funding) and the property development cycle itself. A simplified version of Barras' analysis is provided below starting with the business upturn:

1. Strengthening demand, rising rents and capital values trigger the start of the new development cycle upswing.
2. If credit expansion accompanies the business cycle upswing, it can lead to a full-blown economic boom. The banks may also fund a second wave of speculative development activity.
3. However, because of the long lead times in bringing forward new development, supply remains fairly tight and values continue to rise.
4. By the time the development cycle reaches its peak, the business cycle has already moved into a downswing, accompanied by a tightening of monetary policy to combat the inflationary effects of the economic boom.
5. As the economy subsides, the demand for property declines; rents and values fall as a result and the vacancy stock increases in supply.
6. As the economy moves into recession, the fall in rents and values continues, property companies are hit by the credit squeeze, bankruptcies increase and the development cycle is choked off.

Barras (1994) noted the UK experience was such that a property boom was typically followed by a more muted development cycle. At this point lenders and investors struggled with debts incurred during a downturn or recession and were then unable or disinclined to fund speculative development. At the same time, oversupply of property built in the previous boom was sufficient to meet demand during the whole of the following business cycle. It is only when supply is exhausted, at the start of the next business cycle upswing that the speculative development cycle takes off once more. This is the reason that absorption and vacancy rates are so important to market analysts. Absorption rates are the speed at which vacant space is taken up by the market. Clearly, the likely success of development projects will be influenced by where in the cycle they are started and completed. However, recent experience over the last decade has been for a sustained period of growth in the global economy as well as national economies like the UK, so much so that some commentators are suggesting that the old so called 'boom–bust' economic cycles are gone. It is true to say that many, i.e. those who entered the workforce after 1995, have not experienced an economic downturn in their working lives.

Structural change

Underlying the short-term business cycle are longer-term shifts in occupier requirements that result from structural changes in the economy. For example, the expansion of demand for very large warehouses or so called 'big box' retail space has resulted from strategic reorganisation within the retail and logistics industries, helped by information technology. Similarly, the changes in working practices amongst office occupiers, again encouraged by developments in information technology, will most likely generate demand for new kinds of office building in the future. The term 'hot-desking' was given to the sharing of desk space by more than one employee and is a phenomenon of the late 1990s. Similarly the growth of the telecommuter (people working from home using IT has created demand for study space within residential property). Developers (and investors) who monitor these long-term changes can begin to create new types of product ahead of the rest of the market; equally they can avoid being left with buildings that have a diminishing 'shelf life'. This is where property market research is useful, a subject covered in Chapter 7.

The global economy

The uptake of technology around the world has allowed our environment to be classified as a global one as business became able to market products and services all over the planet. Technology has enabled business to develop partnerships and alliances globally. Prior to globalisation the USA dominated the global economy, however, their share has reduced to around 25 per cent; the trend is expected to continue as the economies of newly industrialised countries, like China, expand at a faster rate. With the global economy and use of the internet, people and businesses are aware that they are competing with others around the world for contracts and business deals.

With the globalisation of business, the economic performance in some countries such as China and the US can substantially affect other regions such as Asia or Europe, and this may need to be taken into account. The last decade has seen a substantial increase in investment in properties from overseas buyers. For example, in Europe there has been an increase in the purchase of investment properties in Turkey and the Adriatic by Northern Europeans, whereas in Australia there is a considerable Asian market buying into investment property in the major cities. Property developers could be affected considerably by changes in the global economy and need to be aware of prevailing trends and forecasted changes.

Discussion point

How has the economic context that property developers operate within changed over the past decade?

Reflective summary

This chapter has contained an overview of the very complex activity of property development, reviewing it as a series of stages involving many actors with differing objectives, operating within the overall context of the building cycle and its interaction with the business and credit cycles. Development may be initiated by any of the main actors identified but it can only take place with the consent of the landowner (unless compulsory purchase powers are used). As a development proceeds through the various stages the developer will become increasingly committed and flexibility will be reduced, exposing the developer to greater risk. Before developers make a commitment to both acquiring land and signing a building contract they should obtain all the necessary consents, carry out all the necessary investigations and secure the necessary finance. In addition, a thorough financial and market evaluation should be carried out with the best information possible to establish the project's viability and the occupier market. The success of a development may often depend on an element of luck as well as the developer's judgement and skill, depending on the interaction of the building and business cycle on completion.

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