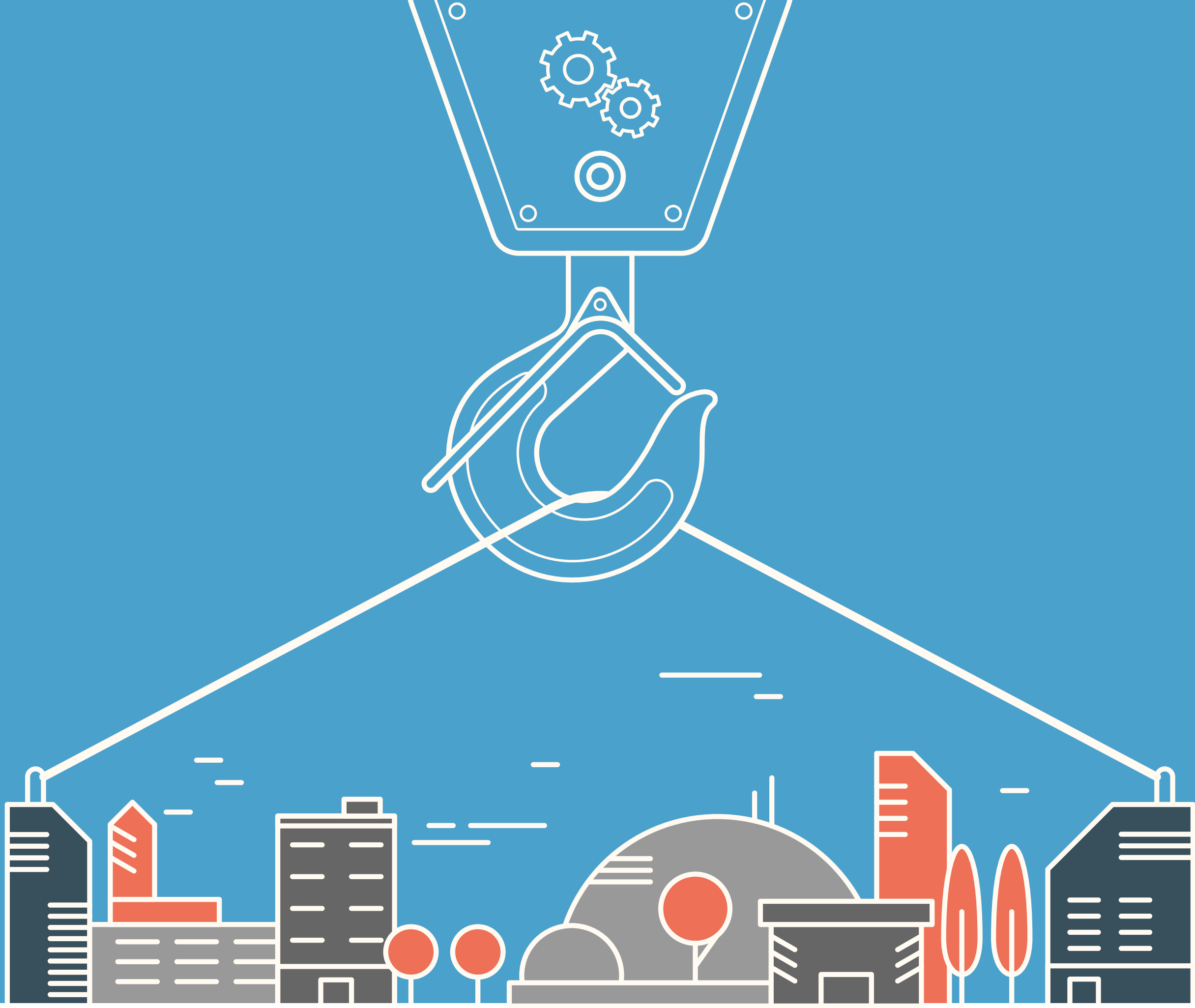
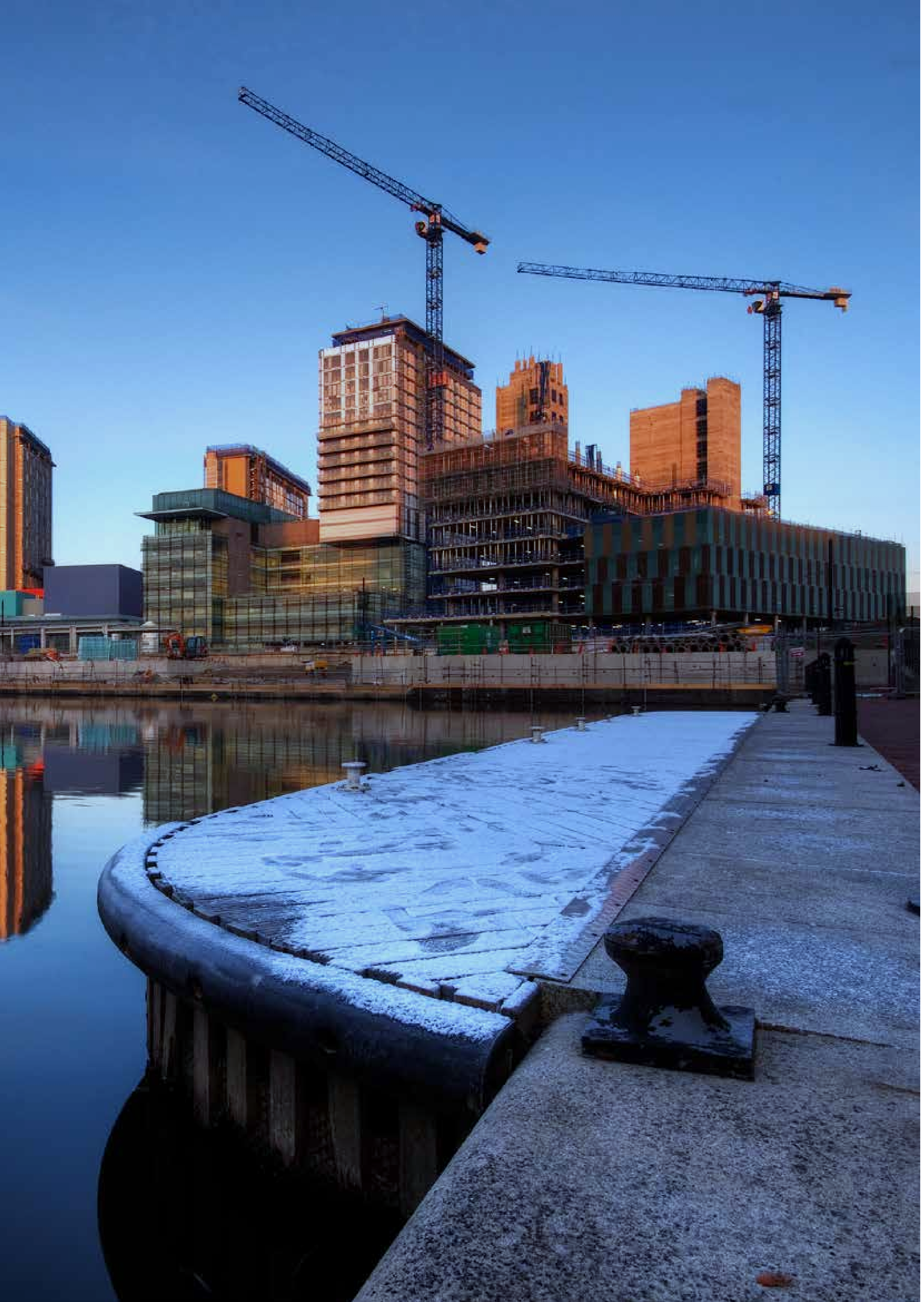


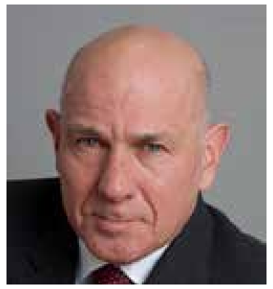
REGIONAL
REVOLUTION

The mayoral elections and their impact on commercial property

Colliers
INTERNATIONAL

Research & Forecasting Report





Dr Walter Boettcher
Director of Research & Forecasting

'The recent mayoral elections are crucially important for real estate investors interested in regional markets. The new mayoral led local combined authorities will be the foci of government devolution and infrastructure investment to the exclusion of other areas. Real estate development will follow this pattern of investment closely.'

- The critical importance of the mayoral elections for the newly local combined authorities (LCAs) has been lost in the media focus on the snap general election.
- The local combined authorities were set up to receive devolved power to enable the efficient formation of locally determined economic and regional development strategies.
- Devolution, comparative advantage, agglomeration economics and international marketing and promotion are all essential ingredients in creating strong local economies as well as supra-regional powerhouses.
- The mayoral election results show that, in some cases, local determinism could be compromised by central party political ideologies.
- The opportunity for devolved LCAs in terms of population growth and increases in economic output and productivity is large and will reward any serious development effort.

While the new mayoral positions look to be less political and more technocratic, national party ideologies may find their way into local debates about effective development strategies.

Mayoral Elections & Regional Economic Strategy

In the midst of Brexit and the UK government's snap election, the local elections received great coverage, less for their own sake, and more perhaps in their perceived role as barometers of how the UK electorate will vote in June's general election. The first mayoral elections for the newly formed LCAs were also held, but, unfortunately, the real importance of the results looks to have been likewise hijacked by the media who chose to focus on their meaning as sentiment indicators for the upcoming general election. In fact, these mayoral elections were crucially important in advancing regional development in general and, specifically, as a further step in pursuing the holy grail of national economic rebalancing – an elusive goal sought by successive governments for a considerable period. Few observers seem to understand this fresh opportunity, while others see the new LCAs as simply a hark back to the regional assemblies created in 1998 and dissolved in 2008/10. The new LCAs are, however, a vitally important mechanism to push forward regional development and economic rebalancing in a way that allows regional stakeholders to self-determine the approach and take direct responsibility for ultimate success or failure. What are these new LCAs? Why are they so important? How do they work? Why is this important for commercial real estate?

'Devolution was not conceived as some charitable power sharing agreement to curry favour, rather it was conceived as a means for ensuring that unexploited region specific opportunities are not missed and that regional comparative advantage is exploited fully.'

Local Combined Authorities – The Concept

Much of the thinking that goes into LCAs can be traced to Michael Heseltine's regional regeneration initiatives and developed further by George Osborne. The thinking has at least four key components: (1) devolution of power; (2) local determination of comparative advantage; (3) transport/communication investment and agglomeration economics; and (4) national/international marketing and promotion. These four main components are co-dependent and the ultimate success of the LCA concept requires that they all fire together so as to bring the right mix of fuels into, for example, the Midlands Engine, to abuse an already slightly hackneyed, if well-conceived metaphor.

1 Devolution of power. The fundamental idea of devolution within this regional development context is the assumption that local stakeholders (businesses, universities, local government, local residents) are in the best position to determine local needs, local resources and thereby local comparative advantage. The UK is a 'unitary state', that is, the UK parliament is supreme and exercises central control over the entire country. This stands in contrast to a 'federal state', where power is divided between central government and local states, such as is found in the US or Germany. In the UK, one obvious result of unitary control has been an undifferentiated system of cities and regions. Some time ago, a regional development strategy was tested in one region and subsequently deemed suitable for every other region, ignoring regional differences altogether. This means that the economic potential of specific regions remained unrealized as the local comparative economic advantages remained unrecognized. Devolution was not conceived as some charitable power sharing agreement to curry favour, rather it was conceived as a means for ensuring that unexploited region specific opportunities are not missed and that regional comparative advantage is exploited fully.

THE THEORETICAL KEYS TO REGIONAL DEVELOPMENT

2. The theory of comparative advantage. As an economic concept, comparative advantage can be traced back to the English political economist David Ricardo in 1817 as part of his international trade theory. A comparative advantage refers to the ability of an economic actor to produce goods or services at a lower opportunity cost than other economic actors, given a unique set of local talent and resources. In a regional context, comparative advantage refers to the capacity for a given region to produce goods and services more efficiently than other regions. Typically, these efficiencies mean that local value add is greater than might otherwise be the case if producing goods and services for which the region is not as well suited. If production decisions are driven by a remote central authority, then there is a risk that local advantages may be missed, whether it is local expertise, local access to specialized raw material inputs, or simply the availability of adequate labour or capital. In particular, central government subsidies to support a regional economy may well distort comparative advantage for purely political reasons. Typically, this will prove unsustainable in the long term. The bottom line is that exploiting comparative advantages is usually part and parcel of generating higher value add activities which, in turn, support profits, investment and wage growth. These advantages are best determined locally.

3. Agglomerative economics and infrastructure. Once devolution has been implemented and encouraged local stakeholders to define comparative advantages and push a development agenda forward, then a key role of national government is to link these emerging regional economic hubs into an integrated supra-region, such as the Northern Powerhouse. Investment in transport and communication linkages is fundamental to maximizing the potential of these hubs. Through such infrastructure linkages market access is enhanced for all local actors, whether it is businesses looking for sales or workers looking for jobs. The larger the catchment, the greater the efficiencies that can be found either through economies of scale or through economies of opportunity. If transport infrastructure increases an effective worker catchment by 50% by reducing journey to work times, then workers will benefit by accessing a wider variety of jobs and businesses will benefit by accessing a larger pool of talent. Both groups will benefit by the greater probability that skills will be more closely matched with requirements. Ultimately, agglomeration increases productivity and, according to academic research, productivity will increase by substantial percentages along with profitability and wages. In this way, central government investment in transport infrastructure is a key ingredient in promoting better balanced regional economic performance by reducing the disparity of productivity and wages between regions.

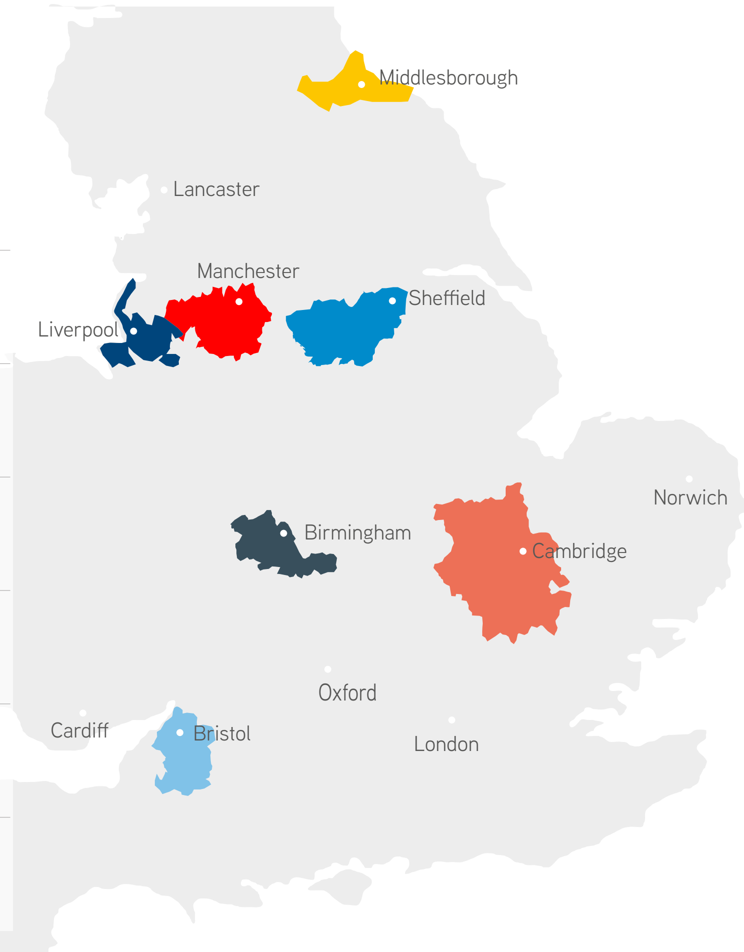
4. International/national marketing and promotion. One of the key benefits of devolution and local determination of development plans is that all local stakeholders have an immediate knowledge of and direct stake in promotion of their local economy outside of their region, both nationally and internationally. When a collective of regional businesses and local government representatives come together in the formation of marketing strategies, this alone demonstrates to investors the political and economic coherence of regions. In a survey conducted by EY in 2016, devolution was acknowledged by 42% of survey respondents as being a key driver in making English regions more attractive for investment. Above all, Greater Manchester has been in the vanguard of demonstrating the effectiveness of international promotion with many other regions seeking to emulate its success. The North West, in general, is on the radar of international investors and, in 2016, annual inward investment was up by 118%, the largest rise across all of the UK government regions (EY, Positive Rebalancing, 2016).

The Importance of Mayors

From a very early point, it was recognized that without a single champion for a new LCA, and without a single point of accountability, the lines of communication with central government would become weak and unfocused as suggested by the experience of previous regional development agencies. It is as important for central government to have a single point of accountability for devolved funds as is it for regional government to have a single voice to represent the demands and needs of the region. Arguably, with Brexit occupying much of the attention of central government the importance of these metro mayors will increase. So important is this concept of a single point of accountability, that the UK chancellor Philip Hammond in the Autumn Statement of 2016 announced that only those LCAs that had signed up to the mayoral system will be granted new borrowing powers to reflect their new responsibilities. This suggests that these entities will be the focus of further devolution and funding.

For domestic and international investors this sent a clear message about where the UK government emphasis might be found. The announcement had its intended effect and focused the minds of those LCAs that were struggling to find consensus among their constituent local authorities. The West of England CA and the Cambridgeshire and Peterborough CA signed up at the last minute, but West Yorkshire is still struggling to find a consensus. The Sheffield City Region, despite great enthusiasm, suffered a legal setback due to the inclusion of parts of Derbyshire and Nottinghamshire in the new entity. This led to a postponement of its mayoral election until 2018. A Yorkshire-wide deal is now being discussed that might amalgamate North, West and South Yorkshire into a single entity. Without West Yorkshire in the system, the vision of a supra-regional Northern Powerhouse will remain a challenge.

Cambridgeshire & Peterborough	*Cambridge CC, Cambridgeshire CC, East Cambridge DC, Fenland DC, Huntingsdon DC, Peterborough CC, South Cambridgeshire DC*
Greater Manchester	*Bolton, Bury, Manchester, Oldham, Rochdale, Salford, Stockport, Tameside, Trafford, Wigan*
Liverpool City Region	*Liverpool, St Helens, Sefton, Knowsley, Wirral, Halton*
Sheffield City Region	*Barnsley, Bassetlaw, Bolsover, Chesterfiled, Derbyshire Dales, NE Derbyshire, Rotherham, Sheffield*
Tees Valley	*Darlington, Hartelpool, Middlesborough, Redcar & Cleveland, Stockton on Tees*
West Midlands	*Birmingham, Wolverhampton, Coventry, Dudley, Sandwell, Solihull, Walsall*
West of England	*Bristol, Bath & NE Somerset, South Gloucestershire*



The Election Result

Arguably, given the role of the new metro mayors within the context of overall regional development strategy, the positions look to be more technical than political. Devolution is not about implementing or promoting a centrally defined national political ideology at a local level. On the contrary, any ideology should be driven locally, independent of national politics. The new mayors should work with local stakeholders, assist and facilitate policy formation and then use the power of the mayor's office to promote this policy to central government. It is ground up, not top down.

In this election, an interesting dichotomy has arisen between the West Midlands LCA and the Greater Manchester LCA – the two largest LCAs in England. In the West Midlands, Andy Street (ex-MD of John Lewis) was elected. In Greater Manchester CA, Andy Burnham (ex-Labour MP and Shadow Cabinet Minister) was elected. Given the existing city rivalry, it will be interesting to see how each fares under different styles of leadership. According to Oxford Economics, the respective GDPs, populations and per capita GDPs were at very similar levels in 2015 (GDP around £51bn). The respective populations are also similar at around 2.8 million, but are forecast to grow at different rates. Between 2015 and 2030, the West Midlands is forecasted to grow by 4% compared to Manchester at 2%. This probably betrays the West Midlands proximity to and the spill-over effects of the rapidly growing South East and East regions as well as assumptions about HS2 timings. Birmingham will see its connection before Manchester. Furthermore, a successful LCA is likely to attract population and these forecasts may change.

Local Combined Authorities (Mayoral-Led)	**GDP 2015** (£ bn)	**Population 2015** (millions)	**GDP / capita** (£ thousands)	**Pop growth to 2030**
West Midlands Andy Street (ex-MD John Lewis, Conservative)	51.7	2.83	18.3	4.0%
Greater Manchester Andy Burnham (ex-MP, Shadow Cabinet, Labour)	51.2	2.76	18.6	2.0%
West of England Tim Bowles (ex-Councilor, businessman, Conservative)	41.2	1.7	24.2	0.8%
Sheffield City Region[1] Mayoral election postponed to 2018	33.4	2.1	15.9	-1.4%
Liverpool City Region Steve Rotherham (ex-MP, local businessman, Labour)	25.7	1.5	17.1	-4.9%
Cambridge & Peterborough James Palmer (ex-DC Leader, businessman, Conservative)	21.1	0.8	26.4	3.3%
Tees Valley Ben Houchen (ex-Councilor, Conservative)	10.9	0.7	15.6	-7.2%
London Sadiq Kahn (ex-MP, Labour)	333.3	8.7	38.3	19.0%

[1]Sheffield mayoral election postponed until 2018 due to unforeseen legal challenge.
Source: Oxford Economics, Colliers International

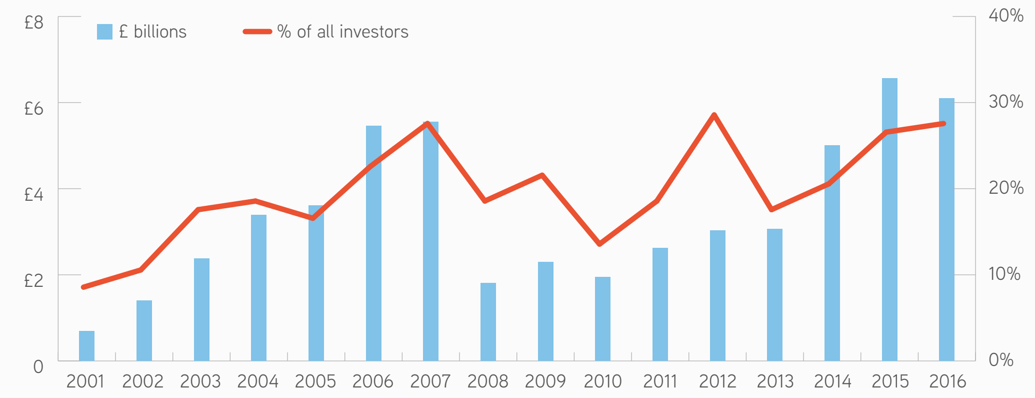
Devolution is not about implementing or promoting a centrally defined national political ideology at a local level. On the contrary, the ideology should be driven locally, independent of national politics.

Implications for Regional Commercial Property

Regional direct property investment increasingly has been on the radar of international investors, many of whom feel that London and assets in other core centres in Europe are expensive and hard to source. Second tier cities and regions are attracting interest because they offer value and because competition is not as keen, hence opportunities are easier to find and easier to transact. Liquidity also looks to be much less of an issue than in the past as numerous office assets in regional CBDs have sold for in excess of the £100 million mark in last few years across markets such as Birmingham, Edinburgh and Manchester. International investors have been part of most of these large deals.

In absolute terms, single asset purchases ex-London have averaged over £20 billion per annum over the last three years. In percentage terms, single asset transactions reached an annual peak of 51% of the UK total by value in 2016. In 2017, so far, the regional volume has been falling, perhaps as investors retreat to core locations in the wake of considerable UK and European political uncertainty. Nevertheless, overseas investors continue to take a growing share of the market. In 2017, their £1.5 billion of investment amounts to almost 30% of the total, with UK institutions taking a more modest 25% market share.

Overseas Investment ex-London



Source: Property Data Ltd

Regional direct property investment has been on the radar of international investors . . .

Regional Targeting of Investment

For both overseas and domestic investors, an obvious result of the mayoral elections will be a de facto list of regional targets where investors can reasonably expect the national and local governments to be focused on pushing forward regional development and economic rebalancing. Likewise, those local combined authorities that have elected mayors have demonstrated, especially to overseas investors, a higher degree of regional coherence than other non-mayoral entities. The mayoral LCAs will also have demonstrated a critical mass of local support with the likelihood that existing institutional structures tasked with encouraging and assisting inward investors will receive a boost to expand their regional promotion activities. If the EY Survey (above) is used as a guide, this suggests that the mayors will be well received as indicators that their respective regions are open for business.

There is a risk that those regions that have not adopted the mayoral led model may be relegated to a second tier, as are those that are in the early stages of trying to pull together a combined authority, or those that have failed. This is not to say that second tier regions will suffer neglect. Despite these initiatives, The Scottish City Region Deals offer similar levels of cohesion and co-ordination, although an additional tier of government means that the link with Westminster is indirect and mediated. Likewise, Local Enterprise Partnerships cover many of the UK's mid-sized cities. Despite these initiatives, overseas investors and, to some extent, domestic investors, are likely to be directed more readily to integrated LCAs.

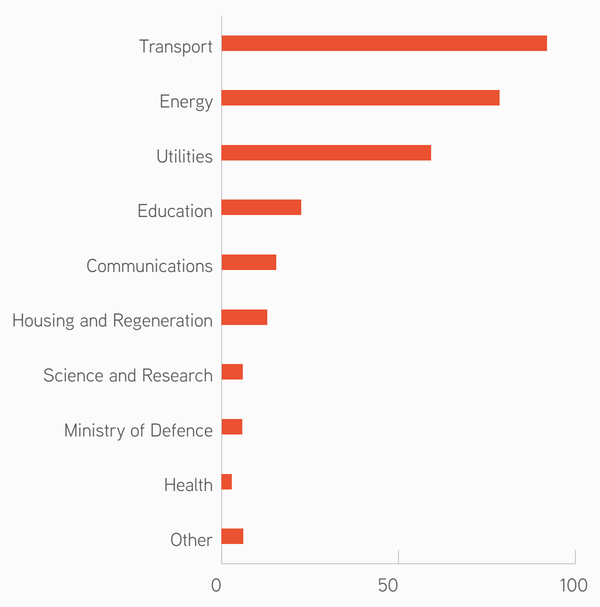
Mayoral led (first tier)	**Non-mayoral led** (second tier)	**LCA proposal pending** (third tier)	**LCA proposal scrapped** (fourth tier)
West Midlands	North East	Cheshire & Warrington	Cumbria
Greater Manchester	West Yorkshire	Heart of South West	East Anglia
West of England		Lancashire	Essex
Liverpool City Region		Leicester & Leicestershire	Greater Lincolnshire
Cambridgeshire & Peterborough			Heart of Hampshire
Tees Valley			Norfolk & Suffolk
Sheffield City Region (2018)			North Midlands
			Solent

Regional Economic Hubs and Infrastructure

While the mayoral election has given a clear pattern of where new and established economic hubs are likely to grow most rapidly, the provisioning of infrastructure is also likely to figure high on the list of regional amenities targeted by commercial property investors. In the same way that Crossrail in London has provided a huge impetus to development wherever a new station is planned, so too will regional infrastructural hubs act as investment magnets.

Even without High Speed 2, several existing transport infrastructure projects are already pulling together regions across all of the UK, irrespective of the degree of local organisation. As of the end of 2016, there are 251 transport projects valued at £92 billion already in the pipeline between now and 2021, with another £46 billion planned from 2021 onwards.

Infrastructure Projects (2016 to 2021) £ billions



Source: National Infrastructure and Construction Pipeline, 2016

In the period to 2021, transport accounts for 31% of infrastructure spending. Energy projects account for another 26% and utilities investment 20%. In all, the top three categories account for over three quarters of all planned infrastructure investment. In the post 2021 period, transport and energy look set to continue to take the lion's share of funds, but as the new LCAs begin to assemble and prioritise their wish lists for investment, the commitment to communications, science and research, housing and regeneration may increase. In fact, in January 2017, the National Infrastructure Commission (NIC) was established as an Executive Agency with an ongoing remit to assess national infrastructure needs, independent from government, and to assist the government in prioritising investment. Given the expertise that has been assembled, the NIC looks set to advise on financing structures so as to attract inward investment into infrastructure, whether through joint ventures, public private partnerships or funding deals. The new LCAs will not necessarily rely solely on central government funds.

Summary

While the UK's political future remains uncertain with respect to its relationship with its main trading partner (the EU), a commitment to UK regional development and infrastructure looks to be increasingly entrenched by statute and ideology. For commercial property investors looking for new opportunities, the regional development agenda offers great long term opportunities. The embryonic regional revolution looks to be gathering pace as it progresses through the step of electing local mayors to promote growth. Identifying specific opportunities that lie within the UK regions is a key challenge, but as this review suggests, the recent mayoral elections have done much to encourage a greater flow of information. Coupled with an emerging programme of sustained infrastructural investment nationwide and the de facto formation of new regional economic and transport hubs, the opportunities will become increasingly apparent. It will not happen overnight. It is a generational plan, but clearly, the best days lie ahead. Vive la révolution!

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2.0
billion square feet
under management

$105
billion in total
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