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# Local asset backed vehicles: The potential for exponential growth as the delivery vehicle of choice for physical regeneration

Received (in revised form): 13th December, 2007

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**Abstract** Nearly half the Regional Development Agencies (RDAs) in England have now adopted the use of local asset backed vehicles (LABVs) as a means to manage and/or develop their property holdings. In doing so, they have collectively invested over £400m of property in 50/50 partnerships with leading private sector regeneration experts such as Igloo Regeneration Ltd. Given the RDAs property holdings represent less than half a per cent of those held by local authorities (£1bn compared with £230bn), the potential impact on the regeneration sector if local authorities embraced this new approach to regeneration could be enormous in terms of leveraging in private sector finance, heralding a new culture of genuine partnership between the public and private sectors and catalysing a paradigm shift in the quantum and quality of physical regeneration in the UK.

**Keywords:** *Local asset backed vehicles, city development companies, joint ventures, public private partnerships, regeneration funding and delivery, local housing companies.*

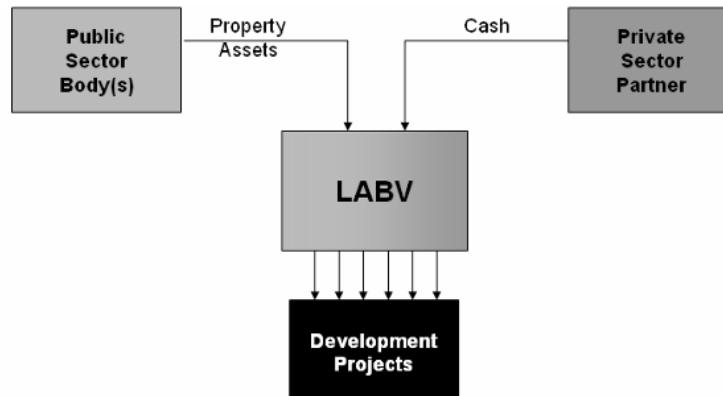
## INTRODUCTION

Local asset backed vehicles (LABVs)<sup>1</sup> are special purpose vehicles owned 50/50 by the public and private sector partners with the specific purpose of carrying out comprehensive, area-based regeneration and/or renewal of operational assets. In essence, the public sector invests property

assets into the vehicle which are matched in cash by the private sector partner, as illustrated in Figure 1.

The partnership may then use these assets as collateral to raise debt financing to develop and regenerate the portfolio. Assets will revert back to the public sector if the partnership does not progress

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**Figure 1:** Local Asset Backed Vehicle structure

them according to pre-agreed timescales through the use of ‘options’ which prevent land-banking, thereby assuring speedier delivery.

This paper traces the emergence of LABVs in the RDA sector and in central government consultation papers. It then sets out the key benefits they offer in the context of existing physical delivery options, such as private finance initiatives (PFIs), development agreements, etc. Finally, it explores the potential for large-scale adoption by councils in England in the context of their property asset base, with particular attention to their form and function in relation and in contrast to the delivery of economic development, namely City Development Companies (CDCs).

### THE EMERGENCE OF LABVs

LABVs firmly joined the regeneration lexicon with publication of the Department for Communities and Local Government (DCLG) Consultation Paper ‘The role of City Development Companies in English cities and city-regions — December 2006’.<sup>2</sup> Section 32 of the paper noted:

‘A number of local authorities are looking at the creation of Local Asset Backed Vehicles (LABVs). These are funds, combining

locally-owned public sector assets and equity from institutional investors, established to finance the delivery of major regeneration outcomes. It is envisaged that these vehicles, with their own boards and management teams, are constituted as limited partnerships. Similar funds have already been established at a regional level and have generally been owned 50/50 by the public and private sector partners. Property development and regeneration projects are delivered according to an agreed business plan established at the outset of the vehicle’s life. Returns made by the vehicle are directed back into the LABV and shared on an equal basis between the partners. The Government is looking at ways in which city development companies and LABVs might interrelate.’

The reference above to funds that ‘have already been established at a regional level’ includes four of the nine RDAs. The pioneer of this approach, however, was in fact British Waterways who launched ISIS Waterside Regeneration in 2002 with a £100m initial equity investment from British Waterways, Amec Developments and Morley Fund Management’s Igloo Fund.

A chronological summary of the emergence of LABVs from British Waterways, through the key regional partnerships today and the first local authority vehicle based on the regional model is shown in Table 1.

**Table 1:** Emergence of LABVs

Date and value <sup>3</sup>	Public sector body	Private sector partner	Now trading as
2002/£50m	British Waterways	Amec/Morley	ISIS Waterside Regeneration
2004/£150m	One NorthEast RDA	UK Land	Buildings for Business
2005/£45m	East Midlands RDA and English Partnerships	Igloo (Morley)	Blueprint
2006/£140m	Northwest RDA	Ashtenne Industrial Fund	Space Northwest
2007/£65m	Advantage West Midlands RDA	Langtree	PxP
2008	London Borough of Croydon	In final stages of procurement	

Control in each of these partnerships is shared 50/50 between the public and private sectors which typically runs for an initial period of around ten years but with the option to renew if the parties elect to do so after this period. The purpose and long-term vision of the vehicle is enshrined in the legal documents which protect the wider economic and social aims of the public sector along with pre-agreed business plans based on the public sector's requirements. Thus a reassuring level of control is retained by the public sector, which may be summarised as follows:

Initially

- shareholder/partnership documentation
- business plan for the partnership as a whole
- property/project specific business plans.

Ongoing

- periodically agreed short-term and medium-term plans
- 50/50 'deadlock' board control
- regular meetings and reporting regime.

The business plans are directed by a board drawn equally from the public and private sectors which directs a small delivery team appointed by the board. This small but focused team is

responsible for the day to day operations.

In response to industry reports and commentary<sup>4</sup> lamenting the ability of local government to catalyse investment, concerns over the fragmentation of regeneration<sup>5</sup> and poor coordination,<sup>6</sup> in the past year the debate concerning treatment of local authority assets has moved on considerably with LABVs (or equivalent models) referenced in Parliamentary working groups and by key governmental advisers:

- In February 2007, the All Party Urban Development Group published its first report 'Loosening the leash' and referred to Regeneration Investment Vehicles — 'packaging up local authority-owned sites and private equity was also seen as a viable way to generate additional infrastructure funding'.<sup>7</sup>
- Professor Michael Parkinson who led the State of the Cities Report commented in the context of Birmingham's masterplanning exercise that the city should leverage its multi-billion pound property portfolio (c. £5bn) to catalyse large scale regeneration.<sup>8</sup> Initial work on the city centre masterplan suggested Birmingham could lead the way by becoming the first UK city to reach agreement with the Government over unlocking the value of the local

**Table 2:** Physical development options compared

	Flexibility	Control	Maximise asset value	Holistic	Structured delivery
Land sale	–	X	X	X	X
Development agreement	X	✓	X	X	–
PFR	X	✓	X	X	✓
URC	✓	–	✓	✓	X
LABV	✓	✓	✓	✓	✓

authority's extensive land and property bank. The council, which owns more than half the city centre, would be able to borrow from private sector consortia against the value of its assets.

- Similarly, Sir Michael Lyons noted that property developers and local authorities must overcome a 'historic mutual suspicion' if the UK's poorest areas are to be regenerated. In a keynote speech at the Royal Institute for British Architecture, Sir Michael said 'residual arrogance' existed on both sides of the divide between the public and private sectors. He said: 'Success means recognising this is not a question of "is this a job for the public or a job for the private sector?". Regeneration is unequivocally a job where we need to get the best out of both sectors.'<sup>9</sup>
- Finally, HM Treasury Review of sub-national economic development and regeneration<sup>10</sup> stressed that Government will support the development of CDCs and, by implication, LABVs as they were introduced in the same consultation paper.

Many local authorities are now investigating the approach either in isolation or as a complementary vehicle to a CDC. These include Croydon, Newham, Coventry, Hull, Carlisle, Birmingham, Tyne & Wear, Sheffield and Newcastle-Gateshead among others.

## THE BENEFITS OF LABVs

Clearly, LABVs are only going to grow in popularity in the local authority sector if there are significant benefits over and above the existing options available, such as land sale, PFI etc.

Table 2 summarises these options in the context of the key criteria central to the delivery of physical regeneration, namely flexibility, control, value, holistic regeneration and delivery.

Elaborating on the table:

- *Land sale*: Local authorities that sell important town centre and/or neighbourhood development sites on a piecemeal basis to satisfy short-term budget issues are abdicating significant control and responsibility for the future of those areas. Piecemeal land sales often do not maximise asset values, as synergy and marriage value between sites is not leveraged. The public sector is giving up inherent ownership rights and responsibilities and relying purely on the planning process to bring forward the economic and social changes that many towns and cities need.
- *Development agreements*: These are a small improvement on simple land sales, but only work in relation to single sites, and therefore do not facilitate holistic area-based regeneration or a platform for structured delivery. They are also unlikely to maximise asset values as — similarly to land sales — they are

usually used in relation to single sites and do not allow for synergistic value between a number of sites. Also the robustness of ‘overage’ as a mechanism to ensure the public sector shares in ‘super profits’ of a highly successful development is increasingly doubted by many in the industry. Finally, development agreements are slow and difficult to agree, as they require significant levels of detail if the public sector is properly to protect the outcomes it desires.

- *PFI*s: These have been a useful tool in generating significant private sector investment into public services. They do not apply to multi-site regeneration, however, and evidence of PFI projects now in operation indicates they are extremely inflexible and thus difficult to operate. Clearly, the idea that you can know today (upon establishing a PFI) what is required out of a facility or relationship in several decades’ time when the vehicle is still in operation is ambitious, to say the least.
- *Urban Regeneration Companies (URCs)*: While URCs are a useful model for aligning stakeholders around a common vision for an area or town, they do not have any asset-holding powers and thus have limited abilities in terms of delivery. Indeed, the Chief Executive of Liverpool’s URC and the first Chair of all URC Chief Executives describes the model as ‘not a very sensible one ... a barmy model’.<sup>11</sup>
- *LABVs*: These contrast favourably with URCs, as they are structured to hold and control property assets, thereby leveraging private sector equity investment and raising third party debt. In contrast to PFI, they are flexible enough to add further projects during the life of the partnership and to change direction

by simple agreement of the parties rather than a significant re-writing of the legal documents.

Although the benefits of LABVs will vary from case to case, they are usually of a regeneration, property, risk transfer and organisational nature.

### Regeneration benefits

LABVs incentivise the private sector to invest and deliver over the longer term, as returns are subject to performance of the partnership over 10–20 years as an entire neighbourhood or town centre is uplifted. This compares with the short-term opportunism and ‘cherry picking’ practised by many developers, which can be damaging to the prospects of neighbouring buildings and the area as a whole.

This longer-term investment perspective is the single most important benefit of the LABV approach and is increasingly being recognised on both sides of the Atlantic as an essential piece of the regeneration jigsaw. For example, the need for ‘long termism’ was acknowledged in the State of the Cities Report<sup>12</sup> and by The Brookings Institution’s reference to ‘patient capital’<sup>13</sup> as ‘crucial to downtown redevelopment but is extremely rare’.

LABVs offer the opportunity to subsidise uneconomic early sites by the prospective future uplift of the whole, and potentially escape reliance on fast disappearing European grant aid (indeed, the East Midlands LABV — ‘Blueprint’ — has been held up as an exemplar by the European Investment Bank (EIB) to implement future European funding). LABVs build a genuine partnership between partners rather than simply the management of a process of a contractual nature (ie PFI or development agreements), which

is inevitably inflexible and confrontational.

The purpose of the vehicle can also be grounded in wider public sector regeneration objectives that are beyond physical development and financial returns. For example, many LABVs are being set up in the context of CDCs and, as such, will be required to underpin economic development objectives. These objectives may be drawn narrowly (eg building incubator units) or widely (eg creating a vibrant and attractive town/city centre that will be attractive to the next generation of entrepreneurs who will be at the heart of the UK's knowledge economy).

Regeneration benefits of an environmental nature could include the provision of combined heat and power systems (with all their associated sustainability benefits) in an LABV project. Generally, it is only larger regeneration schemes (eg Elephant & Castle) that have the scale necessary to incorporate this essential piece of the sustainability jigsaw.

### **Property benefits**

LABVs leverage significant private sector investment and create an opportunity that ignites real enthusiasm in major developers and funds. This is not just from specialists in the PFI market, but from the wider property and funding market as a whole (institutional funds such as Morley (Norwich Union), Bank of Scotland etc.). The attraction to the market relates to the advantages of the partnership structure and the length of the proposed project and returns generated.

The LABV approach to date has generally achieved a significant premium over book value for the properties invested by seeking out the synergies between various sites invested into the

portfolio. Also the private sector is prepared to pay a premium for the opportunity created to invest significant sums into a single vehicle and thus regeneration area.

The public sector also has the potential to tap into substantial returns on their investment by using the commercial ambition of the private sector partner and external debt. Tenfold projected growth over ten years is not untypical in these vehicles.

LABVs also satisfy best value requirements that would otherwise frustrate some regeneration opportunities (that are justified on social or economic but not financial terms) by cross-subsidising between different sites.

These structures are also of a very flexible structure, with the partners retaining the ability to add projects under the main partnership framework, allowing them to procure at will rather than through a pre-determined legal agreement, giving significant fluidity and responsiveness to change.

### **Risk benefits**

The LABV structure allows the public sector to transfer risk, as their assets are assigned a guaranteed minimum price at the outset, regardless of future outcomes.

This transfer of risk takes place despite the retention of significant control through the agreement of business plans set by the public sector at the outset and the creation of a 50/50 partnership structure that enables the public sector to block disagreeable private sector partner proposals, if necessary, over the life of the partnership.

Furthermore, risk reduction through area uplift over the long term and cross-subsidisation between a large number of sites lowers the risk profile compared with doing individual

projects or even phases of individual projects.

### **Organisational benefits**

Given the extraordinarily fragmented nature of regeneration, clearly the LABV approach advocates keeping a portfolio of sites together rather than splitting them up for sale or into individual development agreements. This results in an enormously more efficient structure to deliver regeneration.

For example, organising large-scale regeneration without an LABV requires individual meetings by different site owners/developers with the various planning, transport, s. 106, etc. agencies/departments. In the complex world of UK property development, in order for development to be brought forward, 18 different government approvals are required. For just six sites in a given town centre or neighbourhood this could result in the need for several hundred different meetings and discussions by different parties and different times. This is the antithesis of a holistic approach to regeneration and contrasts starkly with the LABV approach in which the sites are retained in a single portfolio and discussions carried out via the LABV executive team. The potential for more efficient and effective working practices within an LABV is enormous.

### **Grant benefits**

The latest round of European funding is seeking to move the UK away from a grant culture in favour of a loan-based or equity-based funding regime in which returns from regeneration funding by Europe can be 'recycled' into future projects.

Joint European Support for Investment in City Areas (JESSICA)

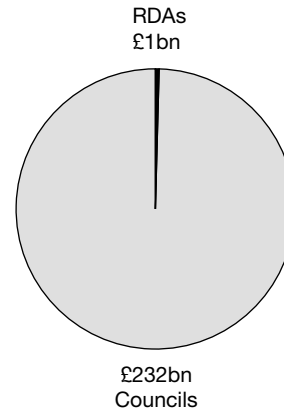
has been established by the European Commission as the initiative to facilitate this change between 2006 and 2013, and 'Urban Development Funds' are the vehicle of choice according to the EIB, who are responsible for implementing the changes. The EIB have put forward 'Blueprint' (ie the East Midlands RDA's LABV — see Table 1 above) as an exemplar for JESSICA funding. Accordingly, councils establishing LABVs will also be creating a vehicle that is likely to meet European funding criteria.

### **RDAs vs LOCAL AUTHORITIES: THE ASSET BASE**

LABVs used by the RDAs have yet to be established at any significant level in the local government sector. The most advanced is the London Borough of Croydon's Urban Regeneration Vehicle, which is in the final stages of procurement for a partner to deliver major physical change across Croydon town centre and provide a brand new civic office facility of *c.* 20,000 square metres.

Given that RDAs control only around £1.2bn of property assets, while the local authorities of England have over £230bn of property on their books, the question of why these more proactive approaches to regeneration are not being considered is an increasingly pertinent one, given the squeeze on public sector finances. Figure 2 illustrates the dramatic contrast in local government property wealth relative to the RDAs.

Part of the reason for the failure of local authorities to take up this approach may lie in the larger percentage of non-operational properties held by RDAs. This, however, is only a partial explanation, as local authorities still hold over £15bn of non-operational assets. In addition, councils can include operational



**Figure 2:** RDA and council assets compared

assets such as civic offices in which they are able to leverage not only the inherent value of the properties, but also their own covenant as an effective pre-let of newly developed offices and/or other council facilities.

### **LABVs: STRATEGY, STRUCTURE AND RESOURCE**

If local authorities are to invest property assets in LABVs, it will be essential for flexibility to be maintained in order that local circumstances may be reflected. Given that one of the greatest challenges to successful large-scale regeneration is effective organisation between the multitude of partners and agencies on both sides of the public and private sectors, however, some clarity is required into the strategy, structure and resourcing of these vehicles.

Effective organisation and communication are especially challenging in the case of major regeneration projects, as stakeholders often include a myriad local, regional, sub-regional and national bodies from business, government and education.

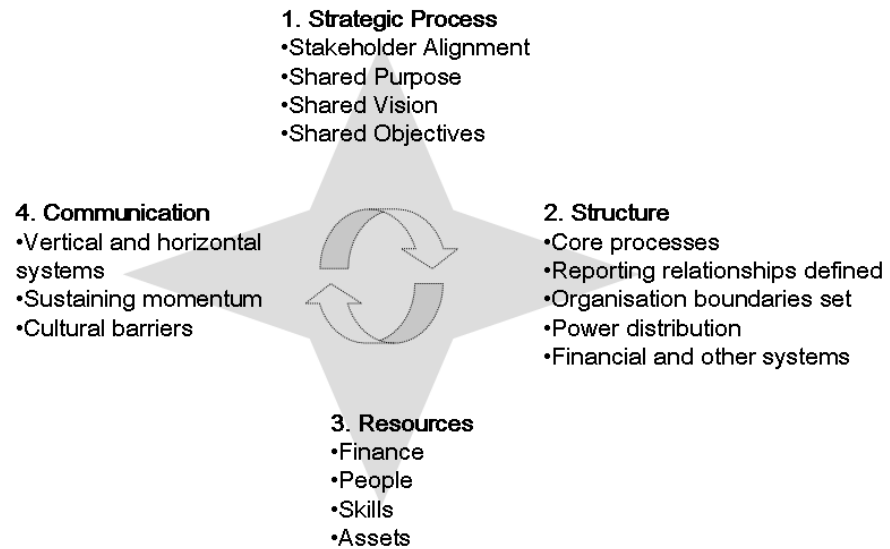
Figure 3 summarises the principles underpinning successful strategic and organisational change in any profession or industry. Clearly, this starts with

agreeing strategic direction followed by establishing a decision-making structure, identifying resources and finally ensuring that all parts of the organisation(s) are in constant communication.

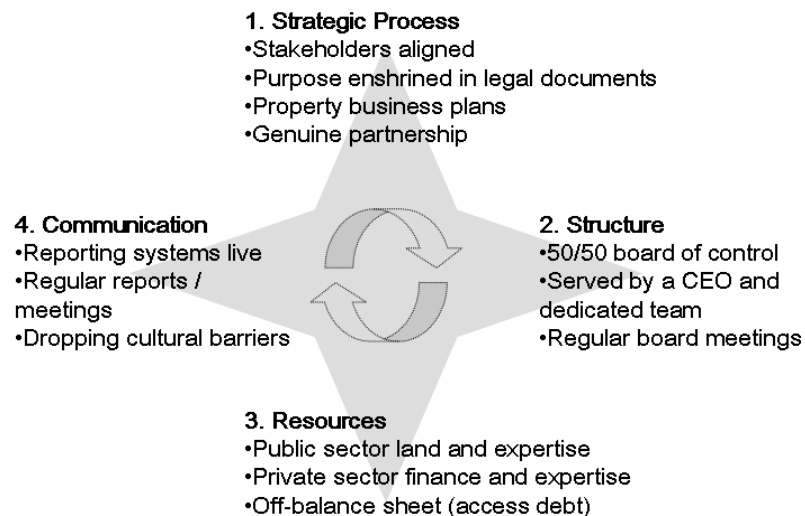
Unfortunately this holistic approach to urban change is rarely undertaken in UK regeneration. Rather, a highly fragmented situation prevails in which the perceived public and private divide is maintained, with each side pursuing different objectives (usually social and economic vs financial); there is not a proper decision-making structure to facilitate decisions between the multitude of stakeholders and then ensure that they are kept; resources are not shared; and finally, communication is very limited or even non-existent owing to fragmentation and the cultural differences between the public and private sectors.

LABVs are an alternative that provide solutions to many of these strategic and organisational challenges. A properly structured LABV will

- align stakeholders behind a common purpose, vision and strategies
- establish a property holding and development structure with clear business planning and decision-making processes



**Figure 3:** Organisational development



**Figure 4:** Organisational development and LABVs

- provide resources in terms of assets, equity and appropriately geared debt
- open channels of communication between the many parties involved.

This process is illustrated in Figure 4.

In addition, as explained above, the LABV approach aligns with central government policy and RDA practice. If required, an LABV can encompass other public sector and private sector bodies

who have land interests in the regeneration area, which would result in a more comprehensive regeneration scheme. It is this flexibility that sets LABVs apart from PFI and development agreement type mechanisms.

### **LABVs AND CDCs**

Assuming there are benefits to be derived from LABVs for councils, the question

**Table 3:** CDCs and LABVs compared

	CDC	LABV
Focus	Economic development	Property development
Funding	Revenue	Property assets, capital, debt
Projects	Revenue	Capital
Physical development	Possibly	Definitely
Partners	Local	National
No. of partners	Many	1
Board	Large, ie 12+	Small, ie c. 4
Control	Private sector led	50/50 public/private
Property assets	Strategic direction	Implementation

remains: How can they fit into the structures and vehicles prevailing in UK regeneration today? As the LABV acronym emerged out of the DCLG Consultation Paper in relation to CDCs, it is worth considering how these two entities will work in relation to each other.

The first CDC was established in Sheffield as 'CreativeSheffield'. Sheffield is being followed by Manchester, Newcastle-Gateshead, Hull and Plymouth, among others. As Central Government's approach to CDCs has been a largely non-prescriptive one, it is difficult to draw a clear picture of CDCs' form and function. One feature is clear at the present time, however: the nature of the funding to date for CDCs is of a revenue nature (usually from the relevant local authority, RDA and EP granting an annual sum of *c.* £250,000 each), ie to date, property assets are not being transferred into the CDC.

Whether this will change going forward remains to be seen. The alternative to investing assets directly into the CDC is of course to establish a separate LABV: Hull City Council is currently investigating a scenario in which they will have a CDC, 'Hull Forward', and an LABV. How these two entities will operate in relation to each other and to other public sector bodies, however, is yet to be established.

The essence of CDCs and LABVs is

provided in the CDC Consultation Paper. In short, CDCs are city or city-region wide economic development companies to drive economic growth. At s. 32 of the paper, LABVs are defined as 'combining locally-owned public sector assets and equity from institutional investors ... to finance delivery'. If one takes these core definitions and develops them in the context of the CDCs and LABVs in operation or planned around the UK, the picture emerges as shown in Table 3.

Elaborating on Table 3:

- *Focus:* The Consultation Paper made clear that the purpose of CDCs is economic development. In the context of CDCs, at least, LABVs are the means to the CDCs' ends, ie property development via the LABV is the means to the CDCs' wider economic objectives for the city. This is not to say that all LABVs will be of an economic development nature, as housing-led LABVs are already being investigated by Newcastle CC and the London Borough of Newham.
- *Funding:* The CDCs set up to date are being funded by grants from the local authority and other public bodies such as the RDA and/or EP (usually for an initial three-year period). LABVs, in contrast, are largely funded by the asset base

- invested by the public sector body (ie properties) and the private sector partner (ie cash). These equity investments are leveraged further via third-party debt secured on the equity investments.
- *Physical Development*: A CDC may carry out physical development; however, given that the handful of CDCs established to date have not been granted property assets, it is possible that the nature of their role will be that of an ‘influencer’ or facilitator of assets owned by others (eg the RDA or local authority) rather than owning and developing assets directly. In contrast, asset ownership and direct control of development is at the core of LABVs.
  - *Partners*: The private sector partners of the public sector on a CDC will be drawn from a cross-section of business people with interests developed locally. An LABV will usually only have one partner, which is likely to be institutional in nature and procured from anywhere in the UK.
  - *Board*: the CDC will be seeking input and consensus from a broad church of businessmen and women in the city, and therefore by necessity will be quite large — possibly up to 20. In contrast, the LABVs are about implementation, and those already in operation have generally kept their boards small with two representatives each from the public and private sectors.
  - *Control*: Most CDCs are being set up to be led by the private sector, ie typically a board drawn 50/50 from the public and private sectors but with a private sector chair. In contrast, a crucial element of LABVs is the 50/50 nature of the vehicle, in order that the wider objectives of the public sector are firmly protected and more balanced regeneration emerges.
  - *Property assets*: As the CDC and LABV relationship is still an embryonic one, it is not possible to be definitive. Given the nature and purpose of the two vehicles, however, it appears likely that the property assets transferred by the local authority will be required to fit in with the broad strategic direction of the CDC, with detailed implementation of the properties being the responsibility of the LABV. Figure 5 summarises this complex relationship.
- This arrangement shows that the local authorities are still at the heart of matters, but with ample opportunity for private sector engagement in relation to economic and physical development. In the CDC, the private sector partners are not ‘locked in’, as they invest only their time (in some instances this will be paid), the CDC being funded entirely by the public sector.
- In contrast, the LABV private sector partner is ‘locked in’, as they will have made an investment of *c.* £100m (based on the LABVs to date — see Table 1 above). Their investment will have been made, however, on the understanding that the vehicle is to bring forward physical development in a manner that generates financial returns and also serves the wider objectives of the public sector: in this case, the aims of the CDC. Hence, the diagram notes strategic input from the CDC into the LABV, and projects emanating from both entities that are complementary. Probably the most effective way for this to be ensured is for the Chief Executive of the CDC to sit on the board of the LABV.
- In summary, a situation in which the property assets of a council effectively remain in their beneficial ownership (ie 50 per cent share ownership of the LABV), are given ‘strategic direction’ by

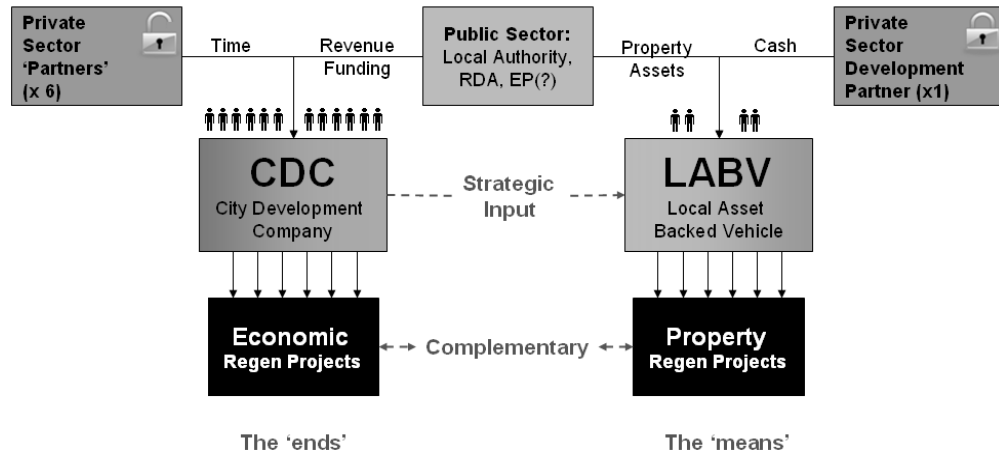


Figure 5: Structuring CDCs and LABVs

the CDC and implemented by the LABV is not an unlikely one.

### LABVs and councils

It is not necessary for councils or other public sector bodies to set up CDCs before considering LABVs. Indeed, a number of councils are already setting up LABVs to pursue town centre regeneration or housing led development. For example:

- London Borough of Croydon is in the final stages of procuring a partner to redevelop major holdings in their town centre and replace 20,000 square metres of civic offices.
- Newcastle City Council is currently procuring a partner to deliver housing led development across the western flank of the city.

Numerous other councils in England and Wales are exploring LABVs for similar purposes.

### CONCLUSIONS

The emergence of these alternative approaches to physical regeneration is a response by the public sector to the

complex myriad challenges posed by large-scale development and regeneration. An LABV will align stakeholders behind a common vision and set in place a firm foundation for long-term investment — the key to more holistic regeneration (ie satisfying physical, social, economic and environmental needs). In most UK development, holistic regeneration is still the exception to the rule, with stakeholders lacking the motivation, authority or organisation to catalyse change. Public bodies are usually frustrated by a mixture of skills shortages and bureaucracy.

LABVs could provide many of the answers to these problems. While the financial benefits are attractive, it is the organisational benefits that could potentially provide a step change in the efficiency and effectiveness of physical regeneration. The opportunity is enormous, with local authority holdings in England alone amounting to over £230bn. The challenges are even greater, however, with Gordon Brown demanding an additional three million homes by 2020, UNICEF reporting that the UK is the worst place among the world's 'advanced nations' for children to live,<sup>14</sup> and the Academy for Sustainable Communities forecasting 70 per cent of

senior regeneration posts being unfulfilled by 2012.<sup>15</sup> In short, UK regeneration needs to deliver more, better and with less experienced professionals.

Clearly, the need to do things differently is compelling. A significant part of the solution could lie in generating a more progressive relationship between public and private sectors that goes beyond the command and control culture of PFI-type mechanisms. LABV structures, which are predicated on developing shared objectives and trust, have the potential to do this.

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