# Building Strong Places

## a new, impactful role for financial institutions

Metro —— Dynamics

## About the project

Metro Dynamics and the Impact Investing Institute were commissioned by Lloyds Banking Group to deliver this project exploring financial institutions' role in place-based impact investing (PBII). The partnership is a unique one, bringing together a retail and commercial bank with respected thought leaders in finance and place. The project has also drawn on expert advice from RW Ventures, LLC on the role of private sector financial institutions in promoting placemaking in the United States.

The research has explored the potential for mainstream financial institutions to activate a new approach to supporting regional regeneration and working in places to improve people's lives. Based on extensive engagement with the bank and with local government representatives in three pathfinder cities—Birmingham, Leeds and Liverpool—this paper sets out early learning and expected success criteria for financial institutions to engage in PBII. The paper concludes with recommendations for Government, financial institutions, and places to take PBII forward in practice.

## About the authors

**Metro Dynamics** is a leading economic consultancy dedicated to helping places by advising those who lead, invest, and do business in local economies. Founded in 2015, Metro Dynamics has established itself as a trusted advisor working with public, private, and third sector clients. Based in London and Manchester, Metro Dynamics combines a deep knowledge of policy, economics, communication, and strategy to support places.

The **Impact Investing Institute**'s mission is to change capital markets so that they are fairer and work better for people and the planet. It is an independent, non-profit organisation working to mobilise more private sector capital, at scale, to address social and environmental challenges. The Impact Investing Institute does this by raising awareness of, addressing barriers to, and increasing confidence in investing with impact. The Institute is part of a global network of National Advisory Boards, which together form the Global Steering Group for Impact Investment.

**Lloyds Banking Group** is a leading UK-based financial services group providing a wide range of banking and financial services, focused on personal and commercial customers. Across its many household names, including Lloyds Bank, Halifax, Bank of Scotland and Scottish Widows, the Group has millions of customers across the UK. Its aim and purpose is to Help Britain Prosper, through operating as a sustainable, responsible, and inclusive organisation.

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This report is also supplemented by two appendices:

A. **The Role of Financial Institutions in Economic Place-making: Lessons from the United States**
Supplementary report by RW Ventures

B. **Place-Based Impact Investing: Toolkit and implementation guide**

# 1. Introduction

The UK has some of the highest levels of sustained inequality in Europe, and a productivity gap between and within places that will take significant intervention to address. In response, Government has set out an ambition to 'level up' the UK's towns and places.

Levelling up means delivering place-based inclusive growth, addressing inequalities in access to opportunities between different parts of the country and within them.[1] It is the latest of decades of policies and approaches that have set out to improve interpersonal and interregional opportunity and outcomes. Meanwhile, structural economic changes and market failures have continued to perpetuate inequality and regional disparities across the UK.

The cumulative effects of inequalities between and within places reflect not only capital and productivity flows, but also unequal outcomes based on other factors such as gender, race and ethnicity.[2] The pandemic has had a disproportionate effect on poorer communities, those in lower-quality housing, as well as on communities with low and unstable incomes. Climate change and the cost of transition to net zero further exacerbate the need for transformational investment which futureproofs both the UK economy as a whole, as well as local economies across the country.

There is no set blueprint to helping economies grow, nor to overcoming inequalities within places. Government, communities and markets *all* have a role to play. One-off Government spending and injections of funding have a part to play going forward, as they have in the past. But more is needed; a risk of relying on government intervention alone is that previous shortcomings are replicated.

This investigation starts with two core assumptions:

- Too many towns, cities and communities in the UK have received inadequate investment over time, with their assets undervalued by traditional markets.
- While some policy and financial intervention should and must come from Government, financial institutions can play a bigger role by working with communities.

Place-based impact investing (PBII) creates meaningful opportunity for private sector financial institutions to join public bodies, regional leaders and local communities in promoting regeneration and sustainable growth, doing so in a way which creates viable financial returns alongside environmental and social benefit.

The prize of this new approach is clear: increased investment that drives growth and regeneration, creating thriving, sustainable local economies as well as attracting future investment in communities.

This report examines the case for a meaningful new approach to regeneration, one empowered by long-term and holistic relationships between financial institutions and places. It particularly explores the role for high street banks. Three pathfinder cities—Birmingham, Leeds and Liverpool—have worked with Lloyds Banking Group to explore how this approach may work in practice, leading to a number of recommendations for Government, financial institutions and places.

Place-based impact investing is an emerging practice of lending and investing with the intention to yield financial returns as well as positive local social, and environmental impact, with a focus on addressing the specific needs of places and populations to enhance local economic prosperity and support sustainable development.

# 2. Regeneration and placemaking: the opportunity for a new approach

The regeneration of the UK's towns and cities has been the focus of successive government policies and initiatives throughout the post-war era. The current Government's levelling up agenda is the latest in a series of models for improving outcomes in places. Approaches have oscillated between physical, economic, and social, but have typically failed to bring these together into a holistic understanding of place.

This section provides an overview of Government approaches to regeneration in the UK, as well as lessons from the US experience which inform consideration of the role for financial institutions in regeneration. The US faces its own challenges in promoting place-based economic development, but has a more embedded capability for private sector involvement in development.

## Regeneration policy in the UK

The scope and targets of UK Government regeneration policy have shifted over time. Physical, social, and economic regeneration have each been a primary focus at various points, with scale ranging from the neighbourhood to the regional level, but consistently driven largely by central government.

The evolution of regeneration policy over time provides us with important lessons that inform any new approach to place-based regeneration:

- Regional development is best served by holistic, co-ordinated intervention that empowers local solutions, driven by place leaders (supported by devolved fiscal and political purview) and informed by local communities and needs.
- Government has a central role in place-based development and regeneration by allocating capital directly to policy priorities, but this funding is most effective where it is coordinated with local community stakeholders and private sector participants.
- Local assets and market opportunities exist in UK's towns and places that can form the basis for private sector investment that introduces additional sources of capital, market discipline and private sector awareness that support the ongoing financial self-sustainability of the local economy well beyond the impact of Government grants.

Structural economic and social challenges cannot be turned around overnight with one short project. The history of the UK's attempts to drive regional development has often been characterised by short-term, single-aim interventions, with discrete grant funding or investment with traditional private finance routes, determined nationally and driven by shifting understandings of what causes disparity and how to change it.

### Evolution of regeneration policy over time

As Table 1 shows, the UK has not landed on any one model for regeneration that sustains itself through changes of government. Regeneration interventions tend to oscillate between place, business and people-based policy.

Table 1. Demonstrative UK Government regeneration policies over time

| Initiative | Focus | Government | Identified Problem | Policy |
|---|---|---|---|---|
| Urban Clearance | Poverty, poor living standards and inner-city congestion | Interwar and post-war governments | Inner urban deprivation | **Physical regeneration** - mass urban clearance and reconstruction |
| Urban Aid Programme | Deprivation and related social issues | Wilson Government (1967-1970) | Inner urban deprivation | **People-based** - grants to local authorities and community groups |
| Urban Areas Act | Deprivation, as a result of structural economic challenges | Callaghan Government (1978-1979) | Inner urban deprivation | Holistic **place-based** support for local authorities |
| Enterprise Zones | Accelerating private sector job creation | Thatcher/Major Governments (1980-97) | Concentrated joblessness | **Business-based** capital subsidy within place |
| Urban Development Corporations (UDCs) | Laying the ground for private sector property investment | Thatcher/Major Governments (1981-97) | Commercial property market failure | **Property led** - UDC's given land assembly and financing powers |
| Single Regeneration Budget | Consolidated finance supporting community driven anti-deprivation work | Major Government (1993-1997) | Overlapping funding streams caused inefficiencies | **People-based** employment and business support with focus on community groups |
| New Deal for Communities | Community led approaches to improving the lives of people living in deprivation | Blair/Brown Governments (1998-2010) | Places with concentrated multiple deprivation | **People and place-based** community funding and capacity building |
| Housing Market Renewal | Physical housing regeneration supporting failing housing markets | Blair/Brown Governments (2002-2011) | Domestic property market failure holding back deprived economies | **Physical regeneration** - demolishing poor quality housing and replacing with higher-quality |
| City region devolution | Support economic agglomeration in pursuit of growth | Coalition Government (2014-2016) | UK cities' relatively poor economic performance | **Place-based** - new Mayoral authorities to control and attract investment in functional economic areas |
| Towns Fund/Levelling Up Fund | Emphasis on funding for towns and places to level up with economically successful places | Johnson Government (2019-ongoing) | Exclusion of left behind places from proceeds of growth | **Place-based and physical regeneration** grants |

### Urban poverty

Interwar and post-war regeneration policy focused on tackling urban poverty and improving people's living conditions. The impact of regeneration programmes was combined with the development of the welfare state, universal healthcare, and access to education for all.

The initial targets of regeneration policy were the industrial and slum areas of inner cities. From the 1930s onward, slum clearance programmes moved hundreds of thousands of people from overcrowded and unsanitary inner-city terraces and tenements to newly built council homes, estates, New Towns and suburbs, which offered outdoor space and improved sanitation facilities. Developments accelerated after the second world war, when large areas of major cities in the UK needed rebuilding following wartime bombing, and the health and welfare of the nation took centre stage for the post-war government.

By the 1960s, social issues in pockets of deprivation became a high priority. Attention was turned to avoiding urban breakdown by addressing root social causes and redistributing resources to deprived communities. In 1967, Harold Wilson's Government established the first national Urban Aid Programme, in which central government distributed the equivalent of £500m (a substantially higher relative sum in the context of the far smaller national economy) in the form of grants to local authorities and community groups to foster a culture of "self-help".[3]

From 1969, Community Development Projects were formed to develop individual solutions to social problems in particular communities. However, central government often disagreed with the solutions different groups proposed, and the programme ended in 1978. The projects did, however, highlight community issues and changing attitudes around the 'social pathology' view of poverty (in which assumptions were made that certain people would live in deprivation), moving to a focus on economic forces as a cause of inequality.[4]

In the midst of structural shifts in the global economy that would spark the process of deindustrialisation in the UK, as well as a series of economic crises, the Callaghan Government introduced the Inner Urban Areas Act, which was the first to take a place-based approach to regeneration, with 42 urban local authorities designated as partners and recipients of substantial government financial support.

After the UK's entry into the European Communities (which later became the EU) in 1973, regional funding was allocated according to need from the European Commission to economically underperforming regions. The funding was for economic development and to support people into training and work; it also included specific support for rural communities in addition to farming support through the Common Agricultural Policy. Following the UK's exit from the EU, this funding will end in the UK in 2023. Government has signalled that it will be replaced in some form by the forthcoming UK Shared Prosperity Fund.

### Private sector led physical regeneration

Economic and physical regeneration shifted to a private sector led model with the Thatcher Government, marking a turning point in regeneration and the role of the state. Policy focused on property and development, driving incentives for businesses and private investment, and worked around, rather than with local authorities.[4]

Despite mixed evaluations – which recognise gentrification as a double-edged sword for some neighbourhoods, as well as early tensions with local communities – the physical transformation of places like the London Docklands would be hailed as a breakthrough in urban regeneration. This was underpinned by the assumption that property-led regeneration would instigate economic growth and deliver social benefits through trickle-down effects. However, these flagship capital investments often failed to provide new jobs at the scale required to drive sustainable economic growth. In some development areas, this approach excluded local communities from decision-making about their place, and contributed to growing inequality, as disadvantaged neighbouring communities were unable to benefit from the new opportunities.

### Boosting declining cities

In addition to physical development-led approaches, in the 1990s, Michael Heseltine, Deputy Prime Minister and Secretary of State for Trade and Industry, and the Major Government introduced streamlined funding via the Single Regeneration Budget (SRB), and an approach targeted at declining cities in the City Challenge programme.[3]

City Challenge and the SRB were more integrated regeneration approaches to place than the previous property led approaches, based on competitive bidding and informed by local challenges and opportunities. The programme brought local authorities and communities together into partnership more than previous regeneration schemes had and encouraged a range of locally-driven solutions. SRB brought together integration of funding and approaches through partnership working. Targeting a number of interventions, projects supported people into work, and regional growth, with regional labour markets strengthened over this period.

### Economic and jobs growth and neighbourhood renewal

The limitations of property-led regeneration models led to a new approach under the Blair and Brown administrations, one that attempted to put communities at the centre of regeneration and economic development. With the establishment of Regional Development Agencies (RDAs), regional development policy prioritised job creation, with entrepreneurship and small and medium enterprises (SME) support as the focus for intervention. Funds were established for investment in physical regeneration, housing, infrastructure, small businesses, and social infrastructure.

This regional approach was combined with place and neighbourhood interventions such as the New Deal for Communities, a people-based programme that aimed to support community growth and capacity building to address multiple deprivation. Physical regeneration in city and town centres was pursued through public-private partnerships (PPPs). PPPs were expanded during and after the 1990s, with public investment aiming to de-risk private sector investment in physical development. In the form of Private Finance Initiative (PFI) contracts, partnerships were also used to improve the public sector estate across the UK and build new hospitals and schools. Due to high costs in early projects and political resistance, use of PFIs was tapered down and eventually discontinued.

### Public-Private Partnership Case Study: Liverpool One[5]

Liverpool One was one of the largest contemporary regeneration efforts, a £1bn 42-acre development aiming to reconnect the city with the harbourside, delivered as a PPP between Liverpool City Council (LCC) and Grosvenor, a leading developer and hereditary estate. In 2000, the Liverpool Vision Urban Regeneration Company was established between Liverpool City Council, English Partnerships and the North West RDA. LCC used compulsory purchase agreements to assemble the land from fragmented land ownership which reduced the risk associated with developing on the site, signing a 250-year lease with the estate. In return, Grosvenor assembled £255m in private equity and £400m in debt finance from four major banks, completing the project in four years. The project has delivered 3300 construction jobs and 5000 permanent jobs, regenerated 42 hectares of land, and contributed to growth in the visitor and retail economy that sets Liverpool apart from the North of England as a whole.

### City region devolution and localism

Following the financial crisis and election of the new Coalition Government, the regional approach to economic development was superseded by the pursuit of city-region devolution and Mayors as drivers of investment outside of London, alongside a business-led model of Local Enterprise Partnerships (LEPs) across England.

Agglomeration, the understanding that physical co-location inherent in cities produces productivity gains benefiting a broader region, had significant influence on the city-devolution process. The creation of Mayoral Combined Authorities created visible local leadership and aimed to maximise investment and job creation in functional economic areas.[6] Devolution deals between city regions and Government included some devolved budgets and some control over funding for infrastructure and skills investment. However, economic development spending remained curtailed by falling council budgets and a resultant focus of spending on statutory needs-based services such as social care.

### Levelling up and left behind places

While post-financial crisis economic policy achieved record employment levels by the mid-2010s, the last decade has been characterised by increasing economic output but falling wage levels and low productivity. Following the EU referendum, the May Government introduced an Industrial Strategy that emphasised infrastructure, people, business and innovation, with locally led strategies developed to grow local economies.

The May Government turned towards the economies and life chances of residents of towns and coastal and rural communities. Regeneration has historically concentrated on cities and urban neighbourhoods, but during this period, attention was turned to the complex issues facing, for example, seaside towns, with poorer education and health outcomes, declining high streets and ageing populations. Funding programmes included the Coastal Communities Fund and Future High Streets Fund.

Recent funding programmes associated with the levelling up agenda have included the Towns Fund and Levelling Up Fund for infrastructure. To make good on the promise of levelling up, policy will need to contend with the climate emergency and recovery from Covid-19 in addition to addressing economic disparities between people and places.

Public grant funding programmes, provision of finance and service delivery are aligning to promote well-being and economic growth. The new UK Infrastructure Bank has said that it intends to provide patient capital[i], and pension schemes are exploring their ability to do the same.[7] Such changes have immense potential to change investment approaches to deliver intentional positive outcomes and could address disparities in investment that have become so apparent.

i Patient capital refers to equity or debt whose providers aim to capture long-term benefits, and who maintain their investment even in the face of adverse short-term conditions.
Deeg and Hardi, "What is Patient Capital and Who Supplies It?" Socio-Economic Review 14(4), Oct

## Economic placemaking: lessons on the role of the financial services sector from the United States

The US context for private sector involvement in regeneration and placemaking is instructive for the UK[ii]; while a vastly different system, with its own challenges and setbacks, it demonstrates that there is a role for the financial services sector in promoting place-based development. In the US, private sector capital is much more active in driving inclusive growth and building prosperity in underserved and marginalised areas. This is driven both by major legislation and regulatory requirements – such as the Community Reinvestment Act (CRA) – and by increased knowledge and therefore use of blended finance models within a market-based development framework. These models use public subsidy, whether that is direct investment or tax incentives, to effectively catalyse private investment in projects aligned with community need.

The appetite for place-based impact investing (PBII) in the US has developed over decades. The maturity of this market demonstrates that there is an enormous amount to be gained from closer partnership between mainstream financial institutions and places, both in terms of outcomes for those places and financial return. Major player ShoreBank, established as a community lender in 1973 with a few hundred thousand dollars, have made $4.1bn in mission investments and financed more than 59,000 affordable homes over 37 years.[8]

A particular strength of the approach to place by banks in the US is through Community Development Financial Institutions (CDFIs). CDFIs include development banks, community loan funds, credit unions and venture funds and they vary by target markets. CDFIs assemble deals, develop early-stage assets and create customer pipelines. The work they do, providing debt and equity to small businesses alongside business support services, is specialised and usually requires subsidy. Public policy support and subsidy, trade associations and rating systems have been critical to the success of CDFIs in the US, and CDFIs now operate at the leading edge of "market development", the US take on financial markets-informed regeneration. In the US, CDFIs and mainstream banks have developed partnerships. Banks not only invest in CDFIs themselves but also act as co-investors.

The US also has a set of tax incentives and regulations that have enabled PBII, particularly as regards to blended finance vehicles. Figure 1 outlines how various kinds of public subsidy can be present and play different roles in a capital stack, illustrating how blended vehicles work in practice across three different sectors and asset classes.

In each case, the finance is structured differently, with varying proportions of the project or programme funding covered by different kinds of investment (senior or junior debt and equity). The public subsidy (through direct grants, deferred or no-interest loans, tax credits and/or guarantees) also plays a different role in each example, including for example in the case of low income housing as both equity and mezzanine debt. Importantly, this image demonstrates that the role of the public subsidy is tailored to the nature of the investment.

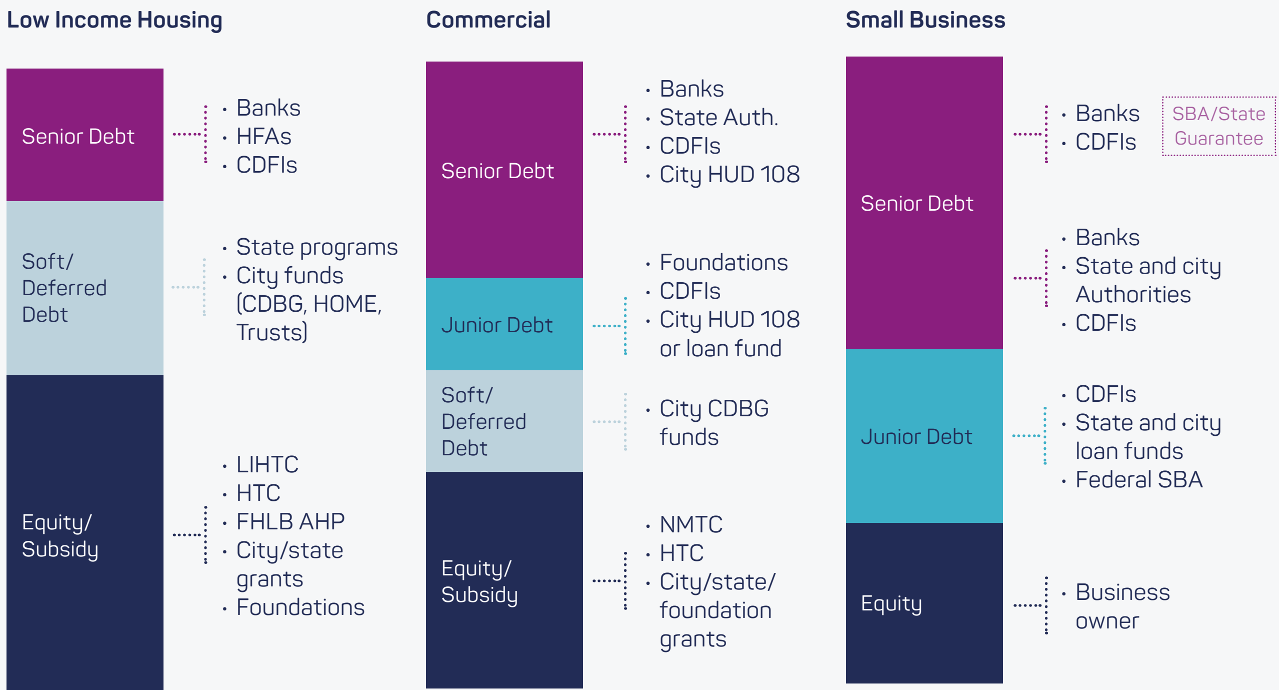
> “
> The best government programs are tailored to leverage the market, not supplant it.
> **Karl Seidman for RW Ventures**

ii This project is supported by a supplementary report by RW Ventures, LLC, a US-based economic development firm who specialise in market-based inclusive growth. The full RW Ventures report and selected case studies (Appendix A) add to the discourse on PBII and regional regeneration.
2016. 10.1093/ser/mww025

### Market-Based Development Case Study: JP Morgan Chase in Detroit, Michigan

In Detroit, JP Morgan Chase has been a key partner in revitalisation efforts. Starting from an initial focus on bringing businesses back into the downtown corridor, their involvement has been influenced by community need and expanded over time to include neighbourhood and community development. Their investments included capitalisation for the Housing for the Future Fund, which provides a range of financial products to help developers bridge the gap between redevelopment costs and rental income in affordable housing. They have also supported a $30m initiative called the Detroit Neighbourhoods Fund and a $6.5m Entrepreneurs of Colour Fund.

**Figure 1. Sample blended finance structures in the US**




Source: Karl Seidman for RW Ventures[iii]

iii HFAs – Housing Finance Agencies (state agencies that deliver financing to support the purchase, development, and rehabilitation of affordable housing)

CDFIs – Community Development Finance Institutions (mission-driven credit unions, banks, loan funds, and venture capital funds)

CDBG – Community Development Block Grant (federal program that provides grants to states, cities, and counties for economic and community development)

HOME – HOME Investment Partnerships Program (federal program that provides grants to states and localities to support building, buying, and/or rehabilitating affordable housing or provide rental assistance)

LIHTC – Low Income Housing Tax Credit (a federal tax credit for affordable housing investments)

HTC – Historic Tax Credits (federal and/or state tax credits for historic buildings that are rehabilitated into income-producing uses)

FHLB AHP – Federal Home Loan Bank Affordable Housing Program (a program that finances the purchase, construction, or rehabilitation of affordable housing through regional cooperative banks)

City HUD 108 – Section 108 Loan Guarantee (the U.S. Department of Housing and Urban Development (HUB) provides cities with low-cost, long-term financing for economic and community development projects)

NMTC – New Markets Tax Credit (federal tax credits to support development projects in low-income communities)

Federal SBA - Federal Small Business Administration (the SBA has lending and investment capital programs to invest in small businesses)

In short, the US has a mature and extensive system of private sector involvement in local development. The exact mechanisms at play within the US are either absent or markedly different in the UK, of course, but the essential dynamics of a market-based economy that has developed unequally and resulted in significant place-based disparities are comparable. With some creative thought and concerted stewardship, the UK could also become a leader in leveraging private finance to address local challenges. It could also learn from the shortcomings of the US's experience activating private partners to improve local outcomes, which has in some cases led to instability, gentrification and imperfect incentives for overcoming market failures.[9]

In order to recreate the positive relationships that US banks and financial institutions have with places within the UK context, a UK bank would need to meaningfully and considerably reshape and restructure its own approach. The key attributes of the US system include:

- **A market-based development model:** The kind of approach to local economic growth that has been led by financial institutions in the US has been rooted in a community and its existing assets, rather than built from a transaction.
- **Well-rounded and embedded priorities:** US financial institutions are often highly specific in terms of geographic targeting and intended outcomes. They then bring the weight of their whole organisation to bear on these priorities, mobilising corporate social responsibility (CSR) initiatives and philanthropic spending alongside new and existing business activities to achieve them.
- **Collaborative working:** mainstream financial institutions work extensively with and through delivery intermediaries such as CDFIs and social enterprises, recognising that in some circumstances and/or localities, they do not have the required expertise or reach. Successful place-based interventions in the US bring together a broad coalition of voices and actors, beyond just bilateral relationships between financial institution and local government.
- **Public sector capacity and capability:** local government is more accustomed to attracting private capital to their projects. There are experienced public sector practitioners working on commercially viable business plans, which results in increased flow of viable, investable deals.
- **Use of public subsidy:** US financial institutions rely heavily on public subsidy in various forms to deliver their place-based impact investments.

US legislation has been specific about focusing the resources of US financial institutions on historically underserved areas. While this was initially seen by many as a regulatory 'must-do', it uncovered profit-making opportunities for banks in areas in which they were not previously active. The approach has not been without challenges – finding the right incentive structures and protections for places are real concerns. But while the policy and regulatory context is different, the US experience reveals real potential for financial institutions to take a role in placemaking and regeneration.

# 3. Activating place-based impact investing in the UK

Place-based impact investing (PBII) is a promising approach with potential to address interregional inequalities and systemic challenges, for instance the climate crisis, in the UK. This section sets out success factors identified through the course of exploring three pathfinder examples (Birmingham, Leeds and Liverpool) with Lloyds Banking Group.

The success factors primarily inform the 'deciding' and 'design' stages of a PBII relationship, as none of the pathfinders reached full 'delivery' during the course of this study. They include points around the building of trust and long-term relationships; establishing momentum and a shared mission; understanding place; and leveraging cross-sector skills and expertise.

## Place-based impact investment: an approach to regional development

A defining characteristic of low income communities and regions is historic under-investment. The reasons for this under-investment are complex, including skills shortages, the absence of business and industrial clusters, and low regional incomes, resulting in an apparent shortage of investable opportunities. Among many interventions, redressing inequality between regions requires creating the conditions for increased investment. The experience from the United States points to the opportunity for a more active role for financial services in achieving this.

Key lessons from the UK's history of seeking to secure regional development are that these efforts do not lead to enduring success where they rely on short term public grant programmes, nor where they focus only on one element of what creates a successful region, demonstrated, for instance, by the limitations of property-based investment in driving real social change. Addressing previous shortcomings therefore requires crafting an approach that increases sustained investment across the various needs of regions.

The role of the public sector in regeneration appeared to shift around the early 2000s from "principal financier to… facilitator, creating the conditions necessary to attract enhanced levels of private sector investment".[10] Private finance has therefore had a significant and direct role in regeneration for some time. However, mainstream UK financial institutions have typically funded regeneration on a transactional basis without participating actively in shaping solutions, with the performance of investments overwhelmingly measured by financial return alone.

In the case of most UK national banks, geography is used as a method of corporate organisation, but place itself is not generally a consideration when it comes to investment capacity and allocation decisions. However, while banks may not yet be explicit or intentional about delivering positive impact in a place, they are active in delivering major investment to communities around the UK. For example, since 2018, Lloyds Banking Group has helped over 265,000 business start-ups, funded energy efficiency improvements on 19.1m sq. ft. of commercial real estate and delivered close to £9bn of finance for the social housing sector.[11]

So, while most financial institutions are already invested in regions across the UK, that investment is typically the result of standard and relatively place-agnostic transactions rather than a holistic and place-specific approach. There have been some selective examples of UK financial institutions focussing on places, for instance the English Cities Fund[iv], which focuses on regeneration in specific cities via large-scale urban regeneration projects. However, intentionally targeting specific UK towns, cities and regions for investment would represent a change in how financial transactions are sourced and prioritised for most mainstream UK financial institutions, especially high street banks.

In approaching place-based financing, there are important strands that can be drawn from the emerging field of impact investment. Where traditional finance's primary purpose is to maximise financial return, impact investing seeks to achieve both financial and social and environmental outcomes. Impact investing is differentiated as an investment practice by: intentionality (actively seeking an identified societal and/or environmental outcome); measurement (in a transparent manner); and additionality (unlocking investment beyond a business as usual approach).

We define place-based impact investing as lending and investment with the intention to yield financial returns as well as positive local social, and environmental impact, with a focus on addressing the specific needs of places and populations to enhance local economic prosperity and support sustainable development. It is differentiated not only by intentionality and additionality, but also by the emphasis on place-specific opportunities. Table 2 describes features of the PBII approach, but it is neither a prescriptive nor an exhaustive list. In practice, PBII will look different in different places, and various financial institutions will activate different tools and methods to embed the approach.

### Table 2. Possible features of the PBII approach

| Intentional investment in the needs of a place | Local partnership and engagement | Additionality, beyond business-as-usual |
|---|---|---|
| • Intention to create positive impact in a particular place alongside financial return.<br>• Portfolio investment that links the inter-dependent and mutually reinforcing set of priorities and transactions that make successful places and improve outcomes for low income, disadvantaged or excluded groups.<br>• Impact measurement, transparency, and information sharing linked to impact as well as financial goals. | • A clearly defined place and objective (or set of objectives), based on understanding of local economic character and need.<br>• Leadership and buy-in from the place being targeted; including local representation and stakeholder and/or community engagement.<br>• Collaboration that emphasises long-term impact, bringing together the right institutional as well as place-based partners. | • Financial institutions working alongside local partners as a problem solver and innovator, with impact goals or objectives informed by local needs as well as institutional appetite.<br>• Crowding in other funders, projects, and transactions into local priorities as the relationship matures; perhaps aligning with complementary Government funds, financial products, and initiatives. |

At the core of the PBII approach is a relationship between a financial institution and place. That partnership could take a number of forms, from informal knowledge exchange to formalised organisational commitments, and in practice could also call on other experts and partners. Done right, the PBII relationship in effect becomes a 'shared space' which brings together relevant partners with the language, tools and access to progress the approach and create real impact in places.

iv English Cities Fund is a joint venture between Homes England, Legal & General, and Muse Developments, founded with an initial investment of £100 million and a mission to form long-term relationships with places to deliver complex and successful urban regeneration projects.

Opportunities to invest in places can be found across sectors and asset classes, with key sectors standing out as capable of delivering risk-adjusted market returns while addressing the needs of places across the UK (figure 2).[v]

**Figure 2. Key sectors for PBII activity**

Having 'place' as an organising principle for investment activity, rather than sector or product lines, challenges traditional ways of working in mainstream lending. But most UK banks are already actively participating in these sectors, and therefore the characteristics of most prospective investments will be familiar. Generally, the relevant sectors have real, income-generating assets providing stable returns.

A key element of success will be attracting the right combination of capital to places, including the right combination of equity, long-term patient capital and appropriate SME financing.

The UK's high street banks are underutilised but natural partners for this agenda. They are spread across the UK, with locally rooted and knowledgeable staff with the experience and connections to invest more effectively in local areas. The range of financing tools and products they offer make them well situated to use PBII to enhance the impact delivered by their core business.

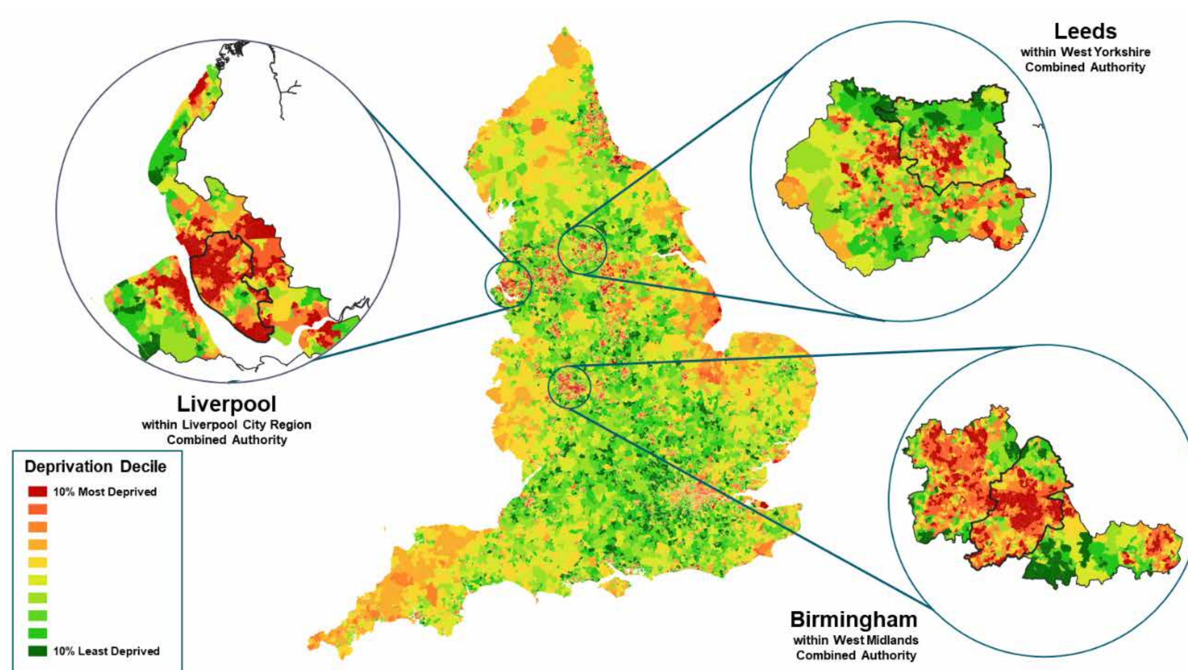
By engaging in PBII, financial institutions could benefit from future-proofed investments, opportunities to build stronger and more enduring client relationships, and investment opportunities that have been specifically shaped to maximise their potential. Places will benefit from increased investment and agency, and the creation of more environmentally and financially sustainable communities. The opportunity of PBII is mutually reinforcing: financial institutions can create new markets for commercially viable investment that generate social benefits, while places gain access to previously untapped capital to fund transformational regeneration without over-reliance on grants.

v These categories build on the PBII conceptual model developed by The Good Economy by including social infrastructure as a key sector for transformative investment by private sector partners. This reflects further development by The Good Economy as well as pathfinder engagement with places.

## Exploratory efforts in place-based impact investing

PBII is not yet a mainstream approach in the UK, making it difficult to evidence and explore within existing corporate, legal and regulatory, and financial structures. It is clear, however, that it will require a new approach to collaboration, risk, services and products. This research has explored PBII via a practical case study with Lloyds Banking Group and three pathfinder places—Birmingham, Leeds, and Liverpool—over the course of six months from May to October 2021.

**Figure 3. Three pathfinder cities and their relative deprivation by IMD decile scores**




Source: Metro Dynamics analysis of ONS English Index of Multiple Deprivation (2019)

In each place, the project team (Lloyds Bank, the Impact Investing Institute, and Metro Dynamics) has been working side-by-side with the city's staff, led by City Council Chief Executives, to identify demonstrator projects: those that either are not currently being funded, or where an impact investing approach could create enhanced social and environmental benefits. On the basis of existing relationships and networks, each city's engagement during this project was focused, at this stage, at the city council level.

An initial scoping period in each place explored their appetite to engage, with high interest demonstrated by each. The places identified priority areas where a new approach could unlock significant local benefit; the partners then explored further to see whether these specific opportunities could be activated. All pathfinders revealed that enhanced interactions with the banking sector, matched with product and service innovation, could drive great local social value as well as financial return. A clear theme running through all of the pathfinders was an emphasis on unlocking capital to address local social and economic needs while at the same time environmentally sustainable solutons – creating futureproofed and resilient places that boost future inclusive economic growth.

In **Birmingham**, the partnership has been working with the City Council's new Chief Executive and Rapid Policy Unit to assess and engage with a diverse portfolio of projects based in East Birmingham. The East Birmingham approach contains a range of projects comprising capital projects in physical development and transport, as well as people-focused interventions in health, skills, and education. The linked projects aim to reconnect this deprived part of the city with the growth and opportunity that the city region is experiencing overall.

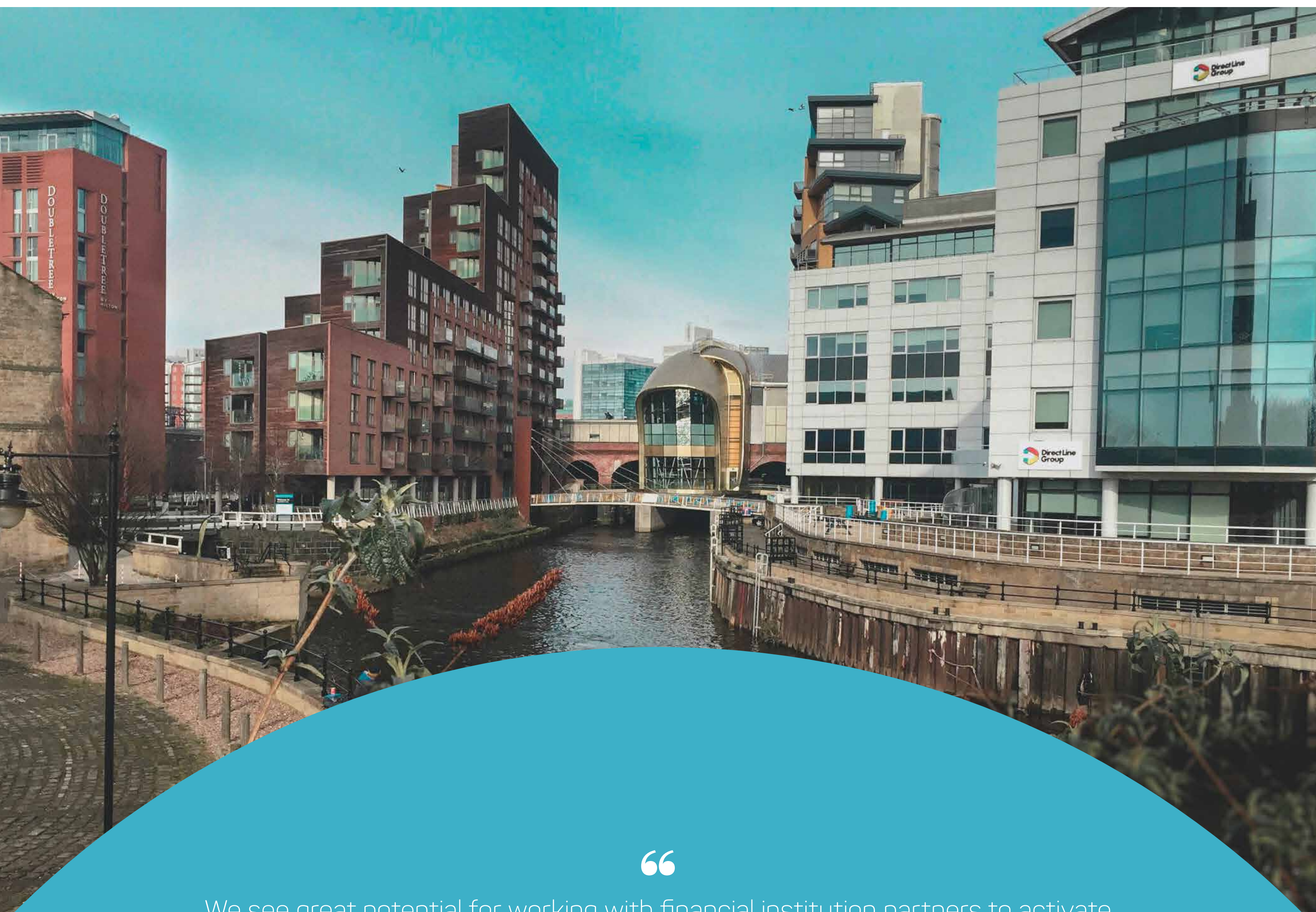
Early discussions explored how a PBII partnership could activate people-focused interventions, for instance community health facilities. These are still possibilities. But early engagement has demonstrated that capital projects tend to be easier to engage with. Banks are generally more experienced in this area and have pre-existing financing models that are more easily transferable to capital projects which incorporate enhanced ESG aims.

"This project has come at a great time as we are strongly promoting the levelling up agenda and exploring new avenues to generate impact in deprived parts of the City. The East Birmingham approach specifically is primed for co-development and investment, with potential to unlock meaningful benefits for residents now and long into the future. Our hope is that through further engagement with Lloyds, we can activate a portfolio of projects that will together catalyse regeneration through the whole of the area.

**Deborah Cadman, Chief Executive, Birmingham City Council**

In **Leeds**, the partnership has been exploring new ways to finance housing and related infrastructure in the city centre. The benefits being pursued in Leeds include: accelerated delivery, cohesion between an otherwise disparate group of developers, connection with regional funds, and greater diversity of type and tenure of homes in order to better address local needs. The partnership is considering: incentives for developers to commit to delivering to higher impact outcomes, a blended finance model, ways to measure the impacts of social infrastructure that would enable the partnership to articulate the resultant savings to the public purse[vi], and accelerating the typical housing delivery cycle by providing projects with financial consistency.

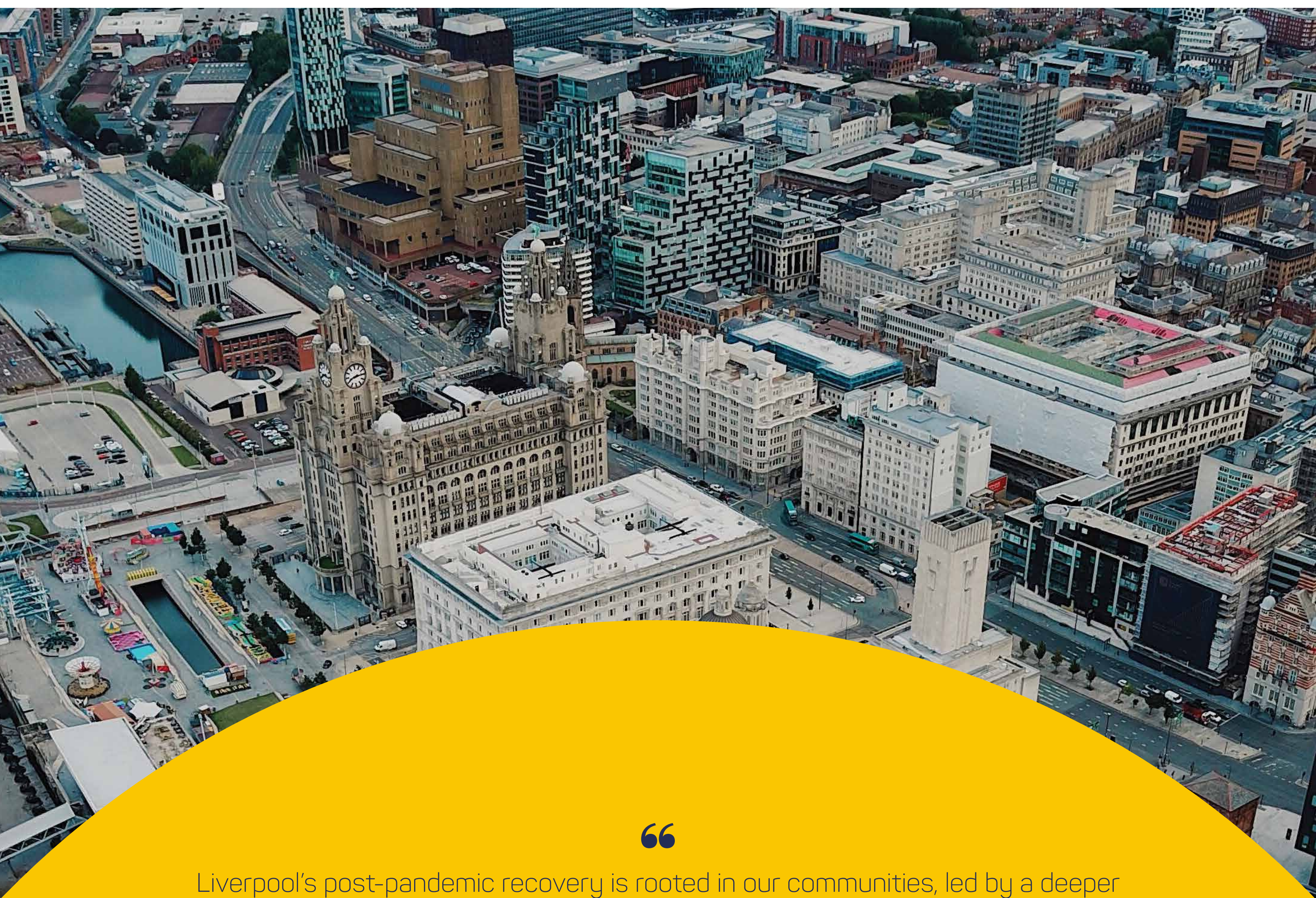
vi One methodology for the consistent measurement, management and reporting of social value, for example, is the National Social Value Measurement Framework by the Social Value Portal. (Link)




> "We see great potential for working with financial institution partners to activate regeneration projects in Leeds given that the sustainable funding of projects with social as well as economic value is critical to their success. There's more to be done to advance the operational specifics of the relationship, but we've already learned from Lloyds and working across our team, and as a result can see how we will be better positioned to articulate the social impacts we are prioritising to a private sector partner in the future.
>
> **Tom Riordan, Chief Executive, Leeds City Council**

In **Liverpool**, the partnership has been working to co-develop a number of opportunities. While exploring the potential for a new approach to domestic retrofit, the partnership is also looking at how to accelerate a stalled physical regeneration scheme, as well as learning more about the local business ecosystem.

The retrofit programme would incentivise private owners to carry out housing retrofit through a neighbourhood approach that would be scalable throughout the city and the UK – this would require complementary Government policy and regulatory support. The pilot being explored would be replicable throughout the UK, but is well-placed to begin in Liverpool by building on their new City Plan.[12] The scale of ambition and acceptance of risk that Lloyds Bank, Liverpool City Council, and partners are demonstrating—even in the exploratory exercise—is demonstrative of the types of opportunities and approaches that a PBII partnership could reveal in practice.



"Liverpool's post-pandemic recovery is rooted in our communities, led by a deeper understanding of the varying needs and challenges that we face across this dynamic city of ours. Our recent engagement with Lloyds has helped us model this approach on housing stock and community energy, testing us on viability and deliverability in a constructive way. We hope the challenge will result in a transformational neighbourhood approach that reflects sound economic development and commercial principles. This is exciting partnership working.

**Tony Reeves, Chief Executive, Liverpool City Council**

### PBII success factors

On the basis of the early experience, the partnership has begun to identify success factors that will influence further exploration and embedding of the PBII approach.

- **The quality of the relationship, defined by trust, honesty and a long-term commitment.**
  Activating a new approach is labour-intensive, requiring top-down will and direction, plus bottom-up buy-in and capacity. This is true on a system-wide level as well as within organisations. This will involve multi-lateral, collaborative project co-design and implementation, a way of working which will require supportive internal processes in partner organisations. The balance of early wins (establishing momentum) with long-term commitment (ensuring follow-through) is an important one which should be actively managed throughout the relationship.
- **A clear and shared understanding of place, including local challenges and priorities.**
  Understanding local stakeholders, governance arrangements, operational structures and political cycles will provide insight as to the institutions with which to partner, the teams and individuals with which to work within those, and any limitations to decision-making and autonomy that may affect the relationship. The ecosystem of local economic development is complex and organic, so there is benefit to focusing on outcomes while adapting to local needs that change over time. Priorities should be shaped around local need, and the stronger the place's pre-existing vision, the more mature the partnership with and impact of the financial institution's involvement is likely to be.
- **The right capabilities and capacity in both places and financial institutions.**
  The need for all partners to have the capacity to engage in sustained and creative problem-solving throughout the relationship, demonstrated through time from leaders as well as across teams. Developing this approach is labour-intensive for both financial institutions and local partners, and the commitment should not be made lightly. Structuring the relationship around a clear vision or objectives can help inform the types of time and resource that should be allocated. The capacity and resource to better assess certain investment risks, combined with an appetite to test and learn, will be essential to the banking sector accessing and providing finance to riskier (but viable) transactions.
- **Innovation to unlock new financing opportunities by pushing beyond business as usual.**
  The value of the PBII approach is in bringing forward transactions that may not have been viable within a business-as-usual approach. Not every project or opportunity explored will be viable, but an important trait of the PBII approach is a mutual willingness to push the boundaries of what is feasible, drawing on the experience and expertise of wider teams to create unique solutions. Many of the investments identified in the pilot regions, in particular in low-income communities, were outside the immediate risk and return constraints of financial institutions. Addressing this challenge will be key to unlocking new investment to support regional regeneration.

During the course of the study, none of the pathfinders reached delivery. The pathfinder projects will continue to progress, revealing additional and rich insights for the delivery of a PBII relationship. However, some early indicators highlight that there will be important considerations that will test the viability of the approach in practice. These include matters such as local authority procurement requirements (necessary for one-off projects, but less so for long-term strategic relationships), the financial burden of regulator approval for new financial vehicles, and how non-financial returns can be monitored and internalised in an organisation that has no established facility for doing so. The challenge of risk and return thresholds indicates a potential role for blended finance[vii] models; the banking sector could also learn from the US experience, and collaborate with other, more specialist finance providers.

None of these challenges appear insurmountable, confirming a viable role for mainstream financial institutions in promoting place-based regeneration. Government and financial institutions could work together to drive private sector capital to places in the UK struggling with historic underinvestment – unlocking tens and even hundreds of billions.

vii Blended finance relies on use of subsidy, primarily from Government, to reduce the risk a financial institution takes on an investment. Reducing the risk of a transaction enables private sector investment to flow more freely to innovative projects or those which are otherwise marginally viable. Blended finance models are fairly common in the UK Government's development finance institutions, targeting positive outcomes alongside financial return in developing and emerging markets across the world.

# 4. Recommendations: establishing a role for financial institutions in regeneration

There is a viable role for financial institutions in activating place-based impact investing (PBII) to deliver transformational regeneration in places. The report concludes with recommendations for each of these bodies to further develop the approach, create evidence of its efficacy and potential, and take pilots through delivery.

A review of regeneration approaches reveals an opportunity for a more holistic and sustainable approach to deliver finance and unlock development in places. The approach has not been taken through to full delivery in any of the pathfinders explored, but valuable insights have emerged for Government, financial institutions, and places. Developing a new approach for financing regeneration is labour intensive. Activating the potential of PBII to generate social impact in places will require leadership, collaboration, and risk-taking. Changing institutional behaviour for any of the entities involved is a challenge, and there is a role for all parties.

## Recommendations for Government and policymakers

There is a clear role for Government in facilitating policy change, introducing regulatory encouragement, and funding to de-risk and incentivise PBII. To advance the PBII agenda, national decision-makers should:

- **Catalyse private sector capital more actively.**
  Deploying tools and incentives to mitigate risk and crowd-in private sector capital. A range of blended finance approaches are available including loan guarantees, tax credits, credit enhancements or technical assistance. Government should engage with financial institutions and other thought leaders to develop the appropriate tools and incentives.
- **Increase capacity to engage with private investors.**
  Supporting the creation of sufficient capacity for places to engage with potential private sector investors, backed by a view on the best local organisational structures to enable agile interactions with financing partners. Local institutions will need the mandate and resources to co-develop collaborative models of investment and facilitate decision-making between Government, communities, and financial institutions.
- **Identify and showcase pioneering PBII pilots.**
  Exploring opportunities and challenges for delivery through an initial number of pilots, with evaluation leading to fine-tuning of the approach. Those pilots could bring together institutions with a known interest and scope for delivering the approach with places that have the knowhow and creativity to demonstrate the potential. There may be the opportunity to test new local institutional models to facilitate public-private co-operation.

## Recommendations for financial institutions

Financial institutions will need to embark upon a programme of culture change to embed both place and impact in their operations. To realise PBII's potential, financial institutions should:

- **Commit financial and human resource to the approach.**
  Engaging active and visible senior-level support as well as the right specialist resources to develop new funding opportunities beyond business as usual. Financial, intellectual and relationship capital will all be necessary to engage with regional and local priorities to develop the approach and create new offerings. This is probably not best done by creating siloed teams for delivering PBII, instead calling on PBII specialists to work closely with coverage and product teams. The approach calls for new products, structures and the capability and capacity for integrated and cross-institutional collaboration.
- **Focus on a select number of PBII relationships.**
  Creating replicable models that can be scaled up as well as transferred to other places. The institution can build momentum and a track record that will enable depth (further engagement and place-specific portfolio) then breadth (new interactions with more places).
- **Create products and approaches which explicitly enable place partnerships.**
  Designing financing models that can overcome barriers and promote enhanced positive impact in places, particularly low income and deprived communities. PBII requires new ways of approaching and assessing risk, as well as consideration of not only financial returns but also social returns. Moreover, the size of investments can vary from traditional thresholds – factors which warrant and reward creative and collective consideration.

## Recommendations for places

Places can be represented by a range of actors, with local and regional authorities a good place to start building relationships; to do so, places need the capacity and knowhow to meaningfully engage. It would be a mistake to see PBII as a solely private sector-led approach with places as reactive. Places can participate fully if they:

- **Articulate clear development priorities and goals.**
  Setting the context for new PBII relationships and engagement, building on existing development strategies. Engaging with private sector partners on the basis of place-wide strategy that looks beyond one-off interventions and projects.
- **Focus and commit resource for engagement with private sector partners.**
  Building on strategic commitments with appropriate technical and delivery capacity. This capacity and resource are necessary to co-develop a shared mission, specific projects and investment models, and then to deliver a long-term partnership.
- **Connect investment with community needs.**
  Representing local engagement and requirements while working with new partners. PBII should not result in new organisations parachuting into communities to make promises or confuse existing lines of communication. Instead, place partners should act as responsible representatives and conduits for local engagement in an emerging PBII relationship.

## Conclusion

There is a role for mainstream financial institutions, including our high street banks, in place-based growth and regeneration in the UK. This report has set out policy and practical proposals which, if implemented, could deliver more and better projects in cities and other areas by creating new forms of investment.

PBII relationships listen and respond thoughtfully to the needs of places and prioritise positive local social and environmental impact alongside appropriate financial return. This report is not a detailed blueprint, but it sets out a way forward to achieving these objectives. It is now up to places, financial institutions and the Government to take up the challenge.

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