Executive Summary

November 2021

Building Strong Places

a new, impactful role for financial institutions

impact investing institute

Metro — Dynamics

LLOYDS BANKING GROUP

Introduction

The UK has some of the highest levels of interpersonal and interregional inequality in Europe, sustained by a productivity gap within and between places.

The current Government's ambition to 'level up' is the latest iteration in decades of policy intended to promote regeneration and regional achievement – from urban clearance programmes to the Urban Areas Act, creation of Urban Development Corporations, Regional Development Agencies, city-region devolution and more.

The evolution of regeneration policy teaches us that:

- Regional development is best served by holistic, co-ordinated intervention that empowers local solutions;
- 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; and
- Local assets and market opportunities exist in UK towns and places that can form the basis for private sector investment, introducing additional sources of capital, market disciplines and private sector awareness that support the ongoing financial self-sustainability of the local economy well beyond the impact of Government grants.

> 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.

Interventions that have set out to improve interpersonal and interregional opportunity and outcomes have consistently fallen short, with the economic crisis caused by Covid-19 and the need for a socially just climate transition highlighting the need for transformational investment that improves community outcomes while futureproofing the UK economy. Working together, places, investors and Government can rise to the challenge, developing new approaches to financing local growth and development and putting places at the centre of decision-making.

Just as the history of UK regeneration highlights an opportunity for a new type of intervention, so too does the US experience, demonstrating that financial services can reap viable returns while driving positive and meaningful local impact.

In the US, a more mature system for private sector participation in regeneration and placemaking demonstrates the role financial services can play in promoting local development, including in low income communities. Major legislation and regulatory requirements, as well as use of public subsidy to catalyse private investment, played a part in developing the system, but the private sector's appetite for this role has also grown as opportunities have become more apparent and investment-ready. Blended finance vehicles play a significant part in empowering American financial institutions' approach to market-based development.

ShoreBank, established as a community lender in 1973 with a few hundred thousand dollars, is a demonstrative example. Over 37 years, they made $4.1bn in mission investments and financed more than 59,000 affordable homes, primarily in low income and underserved communities.

The Intervention: Place-based impact investing

Mainstream financial institutions in the UK have largely funded regional growth and development on a transactional basis, without participating actively in shaping solutions.

Place-based impact investing (PBII) is an approach through which financial institutions can partner with places to facilitate regeneration and sustainable growth through meaningful, co-developed, long-term relationships.

PBII brings together financially viable opportunities with clearly-articulated, positive social and environmental impact to enhance local economic prosperity and resilience. Done right, the PBII relationship becomes a 'shared space' that brings together place and private sector partners with the language, tools and access to create positive impact in places.

The approach is differentiated from business-as-usual by its focus on intentionality and additionality, as well as its emphasis on place specific opportunities.

Intentional investment

Creating positive and measurable impact in a particular place alongside financial return, often through portfolios of linked and mutually reinforcing investment.

Local partnership and engagement

Working alongside local leaders in a clearly defined place, including local engagement, to deliver long-term objectives informed by local socioeconomic need.

Additionality

Product and service innovation that delivers investment not available through conventional approaches, including by crowding in other sources of finance to support local objectives.

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 as well as addressing the needs of places:

Housing social and affordable housing as well as quality rental accomodation across the range of tenures.

Business finance including start-ups, SMEs, manufacturing and high-growth businesses.

Clean energy large schemes and community-based energy.

Infrastructure covering transport and digital infrastructure and connectivity as well as enabling schemes.

Physical regeneration mixed use and community regeneration and high street renewal.

Social infrastructure including health, community facilities and social enterprises.

The UK's high street banks are natural partners for this agenda, with existing lending across the range of relevant sectors and in communities across the UK. 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 local growth without over-reliance on grants.

Pathfinder Projects

Lloyds Banking Group has worked with three pathfinder places—Birmingham, Leeds and Liverpool—to explore PBII in practice. While still at an early stage, the pilots have demonstrated that a broader range of opportunities can be created through dialogue between the financial services sector and local leaders.

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 addressing the climate crisis and pursuing a net zero economy.

Exploring a suite of projects in East Birmingham has revealed how a portfolio of linked interventions could reconnect a deprived part of the city with the growth and opportunity experienced across the city region. 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 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.

Deborah Cadman
Chief Executive - Birmingham City Council

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.

Tom Riordan
Chief Executive - Leeds City Council

In Leeds, the partnership has been exploring new ways to break traditional cycles and patterns of housing delivery by providing greater financial consistency and incentives. The partnership is considering incentive models for developers to deliver greater social value, for instance by creating a greater mix of tenures and uses in new developments, as well as building in social impact measurement to articulate savings to the public purse.

In Liverpool, the city council and Lloyds Banking Group are working closely to explore a replicable approach to retrofit across privately-owned housing stock at a neighbourhood scale. While working together, the partnership has also started to look into mechanisms to accelerate a stalled physical regeneration scheme and understand more about financing challenges facing the local business ecosystem.

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

Together, the partnership has identified initial success factors that will influence further advancement of the PBII approach:

- The quality of the relationship, defined by trust, honesty and a long-term commitment.
- A clear and shared understanding of place, including local challenges and priorities.
- The right capabilities and capacity in both local places and financial institutions.
- Innovation to unlock new financing opportunities by pushing beyond business as usual.

While none of the pathfinder projects have yet reached delivery stage, early indications show that standard risk and return thresholds are a key consideration.

While enhanced financial institution awareness of local opportunities will be enough to activate investment in some places, in other cases there will be a role for appropriate public sector catalytic capital to unlock non-standard solutions that go beyond business as usual.

> “PBII investments listen and respond thoughtfully to the needs of places and prioritise positive local social and environmental impact alongside appropriate financial return.

Recommendations

Developing a new approach for financing regeneration is labour intensive, with important roles for Government, financial institutions, and places.

Changing institutional behaviour for any of the entities involved is a challenge; activating the potential of PBII to generate social impact in places will require leadership, collaboration, and risk-taking.

There is a clear role for **Government** in facilitating policy change, regulatory encouragement, and funding to de-risk and incentivise PBII. The agenda could be best supported through national-level activities that:	▶ **Catalyse private sector capital more actively.** Deploying tools and incentives to mitigate risk and crowd-in private sector capital. ▶ **Increase capacity to engage with private investors.** Empowering places to engage with potential private sector investors, backed by the best local organisational structures to enable agile interactions. ▶ **Identify and showcase pioneering PBII pilots.** Exploring opportunities and challenges for delivery, with evaluation leading to fine-tuning of the approach.
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:	▶ **Dedicate 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. ▶ **Focus on a select number of PBII relationships.** Creating replicable models that can be scaled up as well as transferred to other places. ▶ **Create products and approaches which explicitly enable place partnerships.** Designing financing models that can overcome barriers and promote enhanced positive impact, particularly low income and deprived communities.
Places need the capacity and knowhow to meaningfully engage in this opportunity. 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. ▶ **Focus and commit resource for engagement with private sector partners.** Building on strategic commitments with appropriate technical and delivery capacity. ▶ **Connect investment with community needs.** Representing local engagement and requirements while working with new partners.

There is a role for mainstream financial institutions, including high street banks, in place-based growth and regeneration in the UK. This report sets 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. It is now up to places, financial institutions and the Government to take up the challenge.

About

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 research relied on the participation of individuals and organisations in the three pathfinder cities who have supported this project, providing considerable thought and data, and without whom the pathfinders would not have imparted their valuable insights. 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.

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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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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.

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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.

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