

State Aid Action Plan: Consultation Document – June 2005 Representations submitted on behalf of CABERNET

CABERNET Network and Contributing Authors:

This paper has been developed from the activities of CABERNET Network. It draws on the findings of a Network Position Paper initially developed by the CABERNET Working Group (WG6) on Economic Issues¹.

CABERNET is an expert multidisciplinary European Network that facilitates new practical regeneration solutions for urban brownfields (www.cabernet.org.uk). The Network's vision is to continue to 'enhance rehabilitation of brownfield sites, within the context of sustainable development of European cities, by the provision of an intellectual framework for coordinated research and development of tools.' CABERNET has defined brownfields as sites which:

- have been affected by former uses of the site or surrounding land;
- are derelict or underused;
- are mainly in fully or partly developed urban areas;
- require intervention to bring them back to beneficial use; and
- may have real or perceived contamination problems.

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¹ See <http://www.cabernet.org.uk/network/workinggroups> for further information on Working Group 6 activities

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³ European Commission 5th Research Framework Programme Key Action City of Tomorrow and Cultural Heritage

SUMMARY

Vacant or under-used brownfield land, especially when concentrated in a particular locality, has a negative impact on communities and can increase the difficulty of achieving sustainable urban regeneration.

Various public policy interventions can be adopted to address this problem – which typically is an indicator of failure in the local property market. These interventions can comprise either ‘market substitution’ or ‘market enhancement’ initiatives. Market enhancements, in the form of public-private partnerships, face greater scrutiny and constraints from EU Competition Policy than market displacement by the activity of the public sector.

Well-designed and well-managed public-private partnerships offer access to a wider range of resources than can be provided solely by the public sector. They run fewer risks of crowding-out the private sector thereby, ultimately, promoting competition and innovation. Without access to private sector skills and resources the pace of re-use of brownfield land will be slower than it might otherwise be – to the disadvantage of local communities in terms of the ‘quality of life’ and competitiveness of the area. It is undesirable, therefore, for market enhancement schemes (e.g. partnership schemes that combine the resources of the public and private sectors) that increase the pace of regeneration to face greater scrutiny and restriction from EU Competition Policy than market displacement schemes (e.g. direct development undertaken at a loss by the public sector acting alone).

The different treatment by EU Competition Policy appears, paradoxically, in part to reflect the greater financial transparency of partnerships schemes, rather than the overall value of the assistance afforded to the private sector.

If partnership schemes continue to be inadvertently discouraged because of State aid rules, the pace of brownfield land regeneration will be slower than it might otherwise be, to the detriment of the sustainable regeneration of Europe’s cities. Rather, the Commission needs to recognise the value of Member States achieving urban regeneration through partnership schemes, even in regions that are otherwise buoyant and so do not fall within the scope of Regional Aid Guidelines, as contributing to the renewal of the social and economic fabric of Europe’s cities. Under such circumstances, the risk of providing unfair competitive advantage to enterprises, or of undermining intra-community competition, is negligible.

To date, various partnership schemes have been recognised by the Commission as an appropriate part of the policy response, but only in the assisted regions, or as support to SMEs. It is far less readily accepted as a means of addressing the non-viability of the many brownfield sites in areas of local property market failure in localities outside the assisted areas.

The need therefore is for a formal recognition, by means ‘block exemption’, that the actual beneficiaries of regeneration partnerships are the people living or working near unused brownfield sites, rather than the commercial enterprises that are the formal recipients of grant aid. Without such recognition, effective and lasting partnerships will be hard to achieve and the pace of re-use of brownfield land will be slowed.

The principle of exemptions from the provisions of EU Competition Policy has also been suggested, where ‘lesser’⁴ amounts of aid are involved (LASA), or where the adverse impact on intra-Community trade is ‘limited’ (LET). The challenge, if sustainable regeneration of brownfield land across Europe is to be achieved, is to extend this principle in ways that encourage the achievement of larger scale public-private partnerships that are able to share effectively the risks involved in re-using brownfield land.

⁴ visit www.europa.eu.int/comm/competition/state_aid/others/lesser/en.pdf and www.europa.eu.int/comm/competition/state_aid/others/limited/en.pdf to view consultation papers

1 INTRODUCTION

In the course of its deliberations over the past three years, CABERNET has become very aware that public-private partnerships offer a powerful means to overcome '**market failure**' in local property markets in the remediation and re-use of brownfield land. By sharing the risks and responsibilities of bringing back into beneficial use brownfield land that is not commercially viable to re-develop, such partnerships can, CABERNET believes:

- contribute to the **sustainable regeneration** of Europe's cities;
- improve the **competitiveness** of Europe's cities;
- enhance the **quality of life** of local communities; and
- stimulate **innovation** and **competition** by the private sector.

However, CABERNET has also developed an appreciation of the limitations that current State aid policy, probably inadvertently, places on the ability of Member States (at national and subsidiary levels of government) to enter into effective partnerships with the private sector. Furthermore, CABERNET has learned that other forms of intervention by the public sector, when acting in isolation of the private sector, do not attract the same degree of attention from EU Competition policy because they do not involve State aids. However, CABERNET believes that such public sector interventions run the risk of 'crowding out' the private sector and also reduce the aggregate pace of re-use of brownfield land.

CABERNET therefore welcomes the current review of State aid policy by the Commission, and the opportunity it affords to address the current shortcomings, as identified by CABERNET, with regard to the formation of effective public-private partnerships that have the aim of returning non-commercially viable brownfield land to beneficial use.

This submission comprises:

- as background, a summary of CABERNET's understanding of how current State aid rules inadvertently place limitations on public-private partnerships being used to address market failure and to accelerate the beneficial re-use of brownfield land in cases of market failure;
- comments from CABERNET on certain specific proposals in the Consultation Document that are of relevance to brownfield land; and
- CABERNET's specific recommendations to the Commission for future State aid rules that will better support attempts to use effective public-private partnerships to accelerate the re-use of brownfield land.

2 THE RE-USE OF BROWNFIELD LAND – AN OVERVIEW

CABERNET has defined brownfield land as sites which:

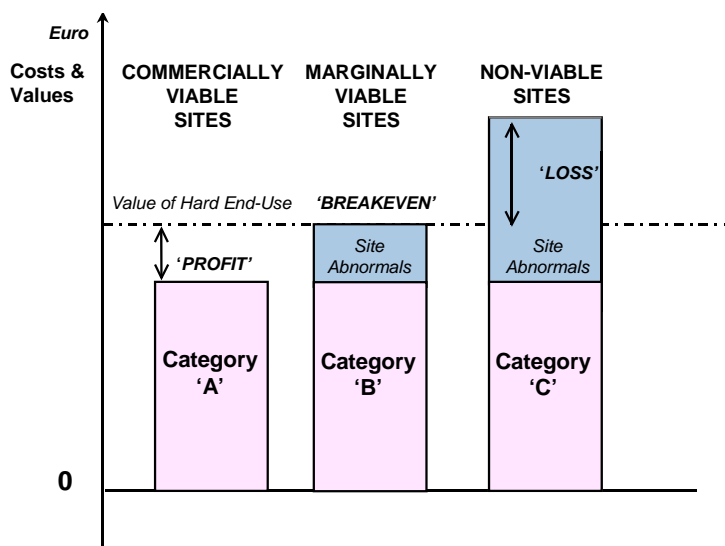
- have been affected by former uses of the site or surrounding land;
- are derelict or underused;
- are mainly in fully or partly developed urban areas;
- require intervention to bring them back to beneficial use; and
- may have real or perceived contamination problems.

Brownfield land is inherently varied in character – there is no such thing as a typical brownfield site. This variability reflects:

- **location** - in terms of property market values, pressures for development and spatial planning designations, etc;
- **physical condition** – in terms of derelict buildings, protected historic buildings, contamination, ground stability, etc; and
- other factors – such as **poor access** to the site, **limited utility** provision, **fragmentation of ownership**, etc.

It is these factors that determine the commercial viability of development of a given parcel of land, and so determine whether a particular brownfield site will readily find a new use, or will remain persistently under- or unused. The effects are summarised schematically in Figure 1:

FIGURE 1 CABERNET 'ABC Model' of Brownfield Land Commercial Viability



However, brownfield land that, for whatever reason, remains vacant or derelict is both:

- a **lost opportunity**, in that if re-used the land can save the release additional greenfield land for urban development, thereby helping to achieve sustainable development; and
- a **problem** that can have a negative impact on the surrounding area and community, increasing the difficulty of achieving effective regeneration.

2.1 The Case for Public Intervention

Whilst certain brownfield land may well be brought back into beneficial use by the market (i.e. Category A sites in Figure 1), in many other cases, vacant and derelict brownfield land persists (i.e. Category B and C sites in Figure 1). These persistent sites can often be concentrated in areas of social need, and so policies to deal with the backlog of vacant and derelict brownfield land are clearly a justifiable and crucial component of urban regeneration in these cases of market failure.

As illustrated in Figure 1, Category A brownfield sites are those whose predicted **redevelopment value is greater than the anticipated costs** of redevelopment. (The costs will include concerns about the risks of dealing with unknown factors and the value will reflect the degree to which a locality has been blighted by onsite or nearby dereliction). The market can redevelop Category A sites without public sector assistance.

Alternatively, if the perceived **redevelopment value is less than anticipated costs**, the site will remain vacant or under-used for the foreseeable future - Category B and C sites in Figure 1. This can only change if there is some means of creating a surplus between costs and value.

Policy initiatives can variously seek:

- to raise predicted values;
- to reduce anticipated costs; or
- a combination of the two.

Category B sites differ from Category C sites, in that the former are marginally non-viable, whereas the latter have more deep-seated difficulties. Thus, only modest adjustments to predicted costs and values are required for the market to redevelop Category B. In contrast, the market is far less likely to be able to respond with Category C sites, implying a more leading role for the public agencies (whether at national, regional or municipality level).

To summarise, a proportion of brownfield sites (those in Category B) can be taken forward by the private sector if the public sector is able to assist with the costs (or values) at the margin.

2.2 Alternative Styles of Intervention

There are essentially two forms of public intervention:

- 'market enhancements'; and
- 'market displacements'.

Market enhancements involve public agencies **improving the working of the market** by sharing, or modifying, the costs and/or risks faced by the private sector or by taking steps to enhance the market values likely to be achieved.

There are a variety of market enhancements available. These include:

- tax incentives;
- 'soft' loans (i.e. loans made on less than commercial terms);
- area-based initiatives (e.g. improving infrastructure or changing the planning status of sites);
- land assembly activities (e.g. compulsory purchase of land from the existing owner); and

- discretionary grant aid (e.g. 'gap funding' to address the private sector cost-value gap).

Discretionary grant aid regimes can be among the most cost-efficient means of dealing with market failure in the remediation and re-use of brownfield land. Such regimes focus on bridging a well-defined 'gap' between the costs and values anticipated values to arise from the redevelopment. The advantages of such forms of funding include:

- only those projects that can demonstrate a need for assistance to become commercially viable actually receive assistance, those that are viable do not;
- there is the opportunity to impose clawback provisions if actual costs are lower than expected, or if values are higher; and
- case-by-case economic appraisals of the direct and indirect effects of the proposed project seeking grant aid can be used to determine the maximum level of grant commensurate with public benefit, or to minimise any displacement effects.

Such forms of 'partnership' funding can however attract the attention of EU Competition Policy and yet, without some form of intervention, the sites will remain under- or unused for the foreseeable future. Non-discretionary systems, such as tax incentives do not attract the same attention from EU Competition Policy, so long as they are available to all projects, whether or not they require assistance. However, tax incentives can be less efficient as they cannot readily be restricted solely to aid commercially non-viable schemes; and also require the developer to have sufficient tax liability if eligible schemes are to be able to realise the full tax incentive.

It would appear that the greater financial transparency of discretionary grant schemes, involving a case-by-case appraisal and negotiation with an individual enterprise, increases concerns over State aids. This is despite an appraisal process that ensures that the level of grant is determined, by a consideration of the economics of the land in question, as the minimum necessary to achieve viability. By contrast, universal tax incentives are usually available without regard to the need to demonstrate site-specific non-viability.

Nevertheless, all forms of market enhancements have the effect of:

- encouraging private sector involvement in sites that they would otherwise decline to invest in;
- stimulating adjustments to market perceptions of costs, risks and values; and
- over time, permitting the public sector to withdraw from the market.

In other words, the pursuit of market enhancements assists with the achievement, over time, of self-sustaining market activity, thereby avoiding the need for continued public sector interventions.

Market displacement, by contrast, involves public agencies **taking over responsibility** for dealing with problematic brownfield land. Under this scenario, the public sector acquires the problem site and takes full responsibility for its reuse, meeting the costs of remediation, developing the desired accommodation, letting to tenants and disposing of the development to the private sector. So long as all transactions are conducted at market value and statutory obligations (such as 'the polluter pays' principle) are respected, no State aid is deemed to apply – even when providing accommodation for an individual enterprise.

The public sector acts as the developer, carrying all the costs and risks, and probably makes a loss on the development as great as, if not greater than, the value of any grant made under a

discretionary grant aid (or 'gap funding') scheme. The role of the private sector in the development process is limited – perhaps it sells the site to the public sector, it rents or buys the completed accommodation and, an investor might buy the occupied development. Inherently, the role of the private sector is reduced to that of a contractor to the public sector, rather than that of a risk-sharing partner. Such a relationship may well be justified by the particular circumstances, such as sites that have deep-seated problems (eg Category C sites).

However, if market displacement activity becomes the norm for **all** non-viable brownfield sites there are adverse implications. Private sector innovation and risk-taking cannot be rewarded and, over time, market innovation and competition in the field of urban regeneration may well be discouraged rather than encouraged. In other words, market displacement activity can over time discourage the private sector from urban regeneration activity except in the most buoyant areas. Any brownfield site, perceived by the market as in any way non-viable will become wholly the responsibility of the public sector.

To summarise, market enhancement activities offer the opportunity to **foster market activity** and to **stimulate innovation and competition** in urban regeneration. Market displacement activities, by contrast, will require the public sector to wholly fund the urban regeneration process other than in the most buoyant market areas.

2.3 The Consequences of Dependence upon Market Displacement Initiatives

On further analysis, dependence on market displacement initiatives by the public sector in the field of urban regeneration has certain undesirable, consequences.

Public agencies typically operate in a cash limited budgetary environment (and therefore have limits placed upon the scale and pace of their operations). The direct provision of land remediation requires **all** costs, not just the **excess** costs, to be addressed by the public sector (again, with consequences for the overall scale or pace of land remediation).

The public sector does not operate in a market environment and may therefore be less innovative, cost-conscious or adaptable to changes in circumstances than the private sector (and so the private sector can offer complementary skills and ideas to those of the public sector).

Continued activity by the private sector can, especially in a given locality, discourage market interest in even commercially viable brownfield sites (thereby exacerbating the underlying cause of market failure, obliging the public sector to take full responsibility for treating brownfield land for the foreseeable future).

To summarise, the above factors mean that over-dependence on direct public sector activity is:

- an inefficient use of limited public funds;
- probably less cost-effective than partnerships with the private sector;
- anti-competitive, in that it discourages the private sector from re-using brownfield land; and
- results in a pace of re-use of brownfield land that is lower than if public-private partnerships are also employed.

This is not to say that there is not a place for direct intervention by the public sector (particularly for Category C sites, as shown in Figure 1), but over-dependence on such means of achieving the re-use brownfield land has its cost – namely, innovation and risk taking in the re-use of brownfield land may be discouraged to the disadvantage of economic growth, social welfare and sustainable development.

2.4 The Core Issue

Public resources for regeneration are limited - whether for national or regional governments, for municipalities or for special-purpose agencies. The public sector, acting alone, lacks the resources to do everything that is needed and yet urban renewal policies that combine the resources of the public and private sectors in partnership can be declared as unfair State aids under EU Competition Policy⁵. A case in point was the UK's former 'Partnership Investment Programme'⁶.

The benefits of partnership working in urban regeneration are several:

- accessing wider sources of funds; increasing the leverage of investment funds through the limited use of public funds;
- encouraging the private sector to develop on brownfield land;
- exploiting private sector skills and expertise; and
- stimulating local market competition.

3 IMPLICATIONS FOR THE REVIEW OF STATE AID RULES

Partnership activity between the public and private sectors, when addressing local property market failures, can **promote** competition and innovation in urban regeneration. It is therefore unfortunate, and probably unintended, that EU Competition Policy has challenged the legality of such schemes, certainly any such schemes available outside the agreed regional policy areas or unless solely for the benefit of SMEs. Various 'market displacement' initiatives are not constrained to a similar degree.

CABERNET recognises that a regeneration perspective is starting to be acknowledged by the European Commission. The approval of the UK's 'Support for Land Remediation' measure⁷ recognised that grant aid can be made to commercial enterprises to bridge the gap between the cost of **site remediation** works and any consequential increase in value of the land.

Outside the assisted areas, the same principles have **not** been extended to assisting the **development of buildings** (which would not otherwise be financially viable) on brownfield sites, even where the property market is weak – with the notable exceptions of assisting the provision of affordable housing. Even in the assisted areas, however, grant aid for non-residential property is limited to the development of general-purpose property to be sold or let on the open market (rather than property designed to meet the particular needs of a specific occupier who has agreed to invest in the region).

⁵ Article 87 of EC Treaty

⁶ An established grant regime, used to further urban and regional regeneration by means of the provision of gap funding for otherwise non-viable commercially-led projects, but which was declared in breach of EU Competition Policy

⁷ See C(2003) 1741 fin, dated 11 June 2003.

In other words, encouraging the active re-use of brownfield land is far less easy than addressing the physical condition of such land – but without a viable end-use, land remediation is unlikely to be achieved, without a viable after-use for the land, site remediation alone does little for local regeneration.

Similarly, it has been proposed, by the Commission, that **smaller scale regeneration** schemes can be supported outside the assisted areas where they contribute to other Commission objectives (such as promoting R&D, heritage conservation, creation of employment and promotion of training) and either have limited effects on intra-Community trade (LET) or involve only modest amounts of aid (LASA). CABERNET understands that it is proposed by the Commission that LET and LASA be afforded 'block exemption' from State aid rules. A wide range of eligible costs is envisaged, but LET aid is to be limited to 3m Euro per enterprise per annum, and solely within a (as yet to be defined) range of specific economic sectors, and LASA aid is to be restricted to a ceiling of 1m Euro over a three year rolling period. Such limits, if applied to brownfield land, would severely constrain the ability of private enterprises to continue in partnerships into the medium term.

In contrast, other than in the case of schemes that are primarily seeking to provide low cost housing, the principle of similarly allowing partnerships to address the cost-value gap in the **development of property** on brownfield sites - even where local property market failure makes such activity non-viable – has **not** been recognised.

To summarise, all financial schemes that involve the private sector, whether in the form of grant aid or tax incentives, may be classed as State aids and immediately come within scope of EU Competition Policy. However, in partnership schemes, whilst the private sector is the formal **recipient** of State aid, it is clear that the **beneficiary** of this aid is the land in question – not the private sector enterprise – and ultimately the benefits accrue to the local community and environment (in terms of an improved quality of life and enhanced competitiveness).

Irrespective of a project's commercial viability, if it is located outside the assisted regions, and the formal recipient or beneficiary of the grant is not an SME, any grant is likely to be considered an unfair State aid. The risks are greater if the scheme is discretionary rather than automatic.

These Competition Policy perspectives of the European Commission severely limit the ability for the public sector to develop effective partnerships, certainly at a site-specific level, with the private sector to bring about the re-use of brownfield land, and especially in those areas outside the assisted regions that are suffering local property market failure. Great care is required when developing grant aid schemes and to achieve 'prior approval' of schemes to avoid them being declared illegal by the Commission.

CABERNET's position is that State aid rules should facilitate 'public-private partnerships' that seek the return to beneficial use of non-viable brownfield sites, whatever the location of the site and irrespective of the size of enterprise that is partnering the public sector.

4 SPECIFIC COMMENTS ON CONSULTATION PAPER

On the basis of a review of the Consultation Paper, CABERNET offers the following detailed comments (with the relevant paragraph to which they relate shown in parentheses).

First, CABERNET supports the assertion (in para 10) that State aids can contribute to achieving common European objectives – such as accelerating the pace of re-use of

brownfield land – typically by correcting market failures – such as the negative externalities of failing to return brownfield land to beneficial use.

CABERNET also notes and supports the view (in para 15) that environmental protection is one of these objectives of common interest and which, by implication, also includes environmental regeneration and sustainable development (an underlying rationale for accelerating the reuse of brownfield land).

In the same light, CABERNET supports the grounds (set out in para 20) for assessing the positive impacts of State aids – namely, a demonstrable ‘appropriateness’ and a focus on ‘proportionality’ of the measure to a defined common interest – and the level of distortion that the measure creates. On this basis, CABERNET believes discretionary State aids that are carefully tailored to the particular circumstances of a brownfield site’s regeneration are fully justifiable.

Such assistance, when carefully structured, offers a proportionate response to the relevant market failure exhibited in many cases of brownfield land remaining under- or un-used – namely, the failure of the market to reflect the ‘public good’ achieving by returning brownfield land to new beneficial uses (as discussed in para 23 and on page 7).

CABERNET also supports the view (set out in para 25) that confirms that State aids can be justified when necessary to stimulate innovation in circumstances that neither ‘crowds out’ private initiative nor lead to unfair competition. In CABERNET’s opinion, ‘market enhancements’ (such as public-private partnerships) are superior to ‘market displacement’ on both counts when addressing brownfield land.

For the above reasons, CABERNET fully supports the principle of ‘block exemptions’ (as discussed in para 35) and would urge the Commission to apply such an approach to Member States’ initiatives to develop public-private partnerships aimed to accelerate the re-use of brownfield land. CABERNET sees the accelerated re-use of brownfield land as fully supporting the environment (an area explicitly referred to under para 36 as worthy of such block exemption).

Under- and un-used brownfield land is an issue in many highly-developed regions of Europe and not just the least-developed. Consequently, CABERNET views the better re-use of brownfield land as contributing to European regional ‘cohesion’ (as discussed in para 40) – improving both quality of life and competitiveness of those regions and localities with greater amounts of under- or un-used brownfield land. Similarly, CABERNET supports the view (discussed in para 44) that State aids can be relevant to tackling issues outside the ‘least-developed regions’.

Fundamentally, making better use of brownfield land across Europe is under-pinned by a wish to contribute towards an environmentally sustainable future (as discussed in section II.7). State aids in support of the better re-use of brownfield land better integrate the negative externalities of leaving brownfield land under-used in private sector investment decisions.

5 RECOMMENDATIONS

CABERNET believes the EU has an important role to play in encouraging appropriate private-public sector cooperation in the sustainable regeneration of marginally non-viable brownfield land.

Furthermore, CABERNET believes that the following specific recommendations are in the interest of accelerating the pace of re-use of brownfield land - land that might otherwise remain unused:

- that in the case of State aids designed to address the 'cost-value' gap in the re-use of commercially non-viable brownfield land, recognition is given to the beneficiary being the local community and environment and **not** the enterprise formally in receipt of the assistance; and
- that a 'block exemption' (or 'derogation') from the provisions of State aids be introduced for grant aid used specifically to secure the re-use brownfield land in areas of demonstrable local property market failure, irrespective of the region in which the land is situated or the size of the enterprise that is the formal recipient of the grant.

All aid instruments would need to be wholly transparent in order to benefit from the 'block exemption' and to demonstrate that the grant awarded was no more than the 'gap' between costs and the value to the private sector of the project outputs. Eligible instruments would of course also need to respect the principle of 'the polluter pays'.

As with the recently proposed relaxations for smaller scale initiatives (ie the 'LASA' and 'LET' exemptions), limits could be set in terms of the maximum grant per individual project in financial terms, and / or in terms of the aggregate amounts of grant per recipient per annum, but these **must** be at levels that permit non-SMEs to participate in meaningful ways in partnerships that can continue to operate over the medium term.

With such a 'block exemption', Member States will be able to develop effective, transparent partnerships with the private sector, without the need to pursue a time-consuming 'prior notification' process. Such partnerships would be able to share the risks and responsibilities of bringing brownfield land back into beneficial use – land that might otherwise remain unused – furthering the sustainable regeneration of Europe's cities

Without such an 'block exemption' Member States will continue to be required to demonstrate that each scheme is a tool of regional policy, or is restricted solely to the SME sector, and will be obliged to depend on primarily public sector initiatives for urban regeneration activities – with adverse consequences for the pace and scale of re-use of brownfield land.

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