Item No. 5	Classification: Open	Date:	Meeting Name: Regeneration and Leisure Scrutiny Sub-Committee
Report title:	**Tax Increment Financing – Briefing Note**		
Ward(s) or groups affected:	All		
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INTRODUCTION

1. The Government announced in September 2010 that they would introduce Tax Increment Financing (TIF) powers, that would allow local authorities to borrow against locally raised business rates. The statement said that funding raised through TIF could be used to fund key infrastructure and other capital projects, which will support economic development.

2. In October 2010, as part of the Comprehensive Spending Review, the Government announced the introduction of new borrowing powers to handle TIF. The new powers will allow local authorities to borrow against predicted future growth in their local business rates which will arise as a result of regeneration or infrastructure enhancement.

BACKGROUND

3. The Government's White Paper Local Growth: realising every place's potential sees the introduction of TIF as one of the principal incentives for driving forward local economic growth. The White Paper promises new borrowing powers to enable local authorities to carry out TIF. It aims to give councils access to the resources necessary to support investment and unlock growth. In determining the affordability of borrowing for capital purposes local authorities will be able to factor in the full benefits of growth in local business rate income.

4. As a counterpoint, there was an announcement in the 2009 Budget to halve public sector net investment from 2009 levels by 50 per cent by 2014 (capital spending will fall from £44bn 2009/10 to £22bn in 2013/14). Though the government has committed to protect economically productive investment, the 50 per cent reduction has been retained. At a time when the need for councils to stimulate economic growth within their communities is important, there will be limited grant available from the government to do so. The economic downturn has severely limited other capital finance options, such as Section 106, capital receipts and private development.

5. The UK Treasury said that TIF would operate within a 'carefully designed framework of rules, which the Government will work closely with local authorities to design'. Ultimate responsibility is likely to be retained by the Treasury, meaning each TIF scheme will have to meet specific central criteria before approval can be granted. Its implementation could be as late as

2013/14, and the impact of the borrowing on the national balance-sheet would mean that central government will want to keep a tight rein on its limits.

CONTENT

6. Local authorities can currently borrow against future revenue streams, but business rates are precluded as these are centralised and redistributed by central government. Under a TIF scheme, central government will grant local authorities the ability to capture future uplifts in business rate growth. This enables the local authority to borrow to finance the supporting infrastructure and capital projects, such as transport and housing, needed to enable business growth. When a development or public project is carried out, there is often an increase in the value of surrounding real estate, and perhaps new investment (new or rehabilitated buildings, for example).

7. The increased site value and investment would generate increased tax revenues. The increased tax revenues are the 'tax increment'. TIF is designed to channel funding toward improvements in distressed or underdeveloped areas where development might not otherwise occur. TIF creates funding for 'public' projects that may otherwise be unaffordable, by borrowing against future property tax revenues.

8. TIF is based on business rates, and therefore residential schemes would sit outside this initiative. There are alternative government funded schemes that target residential growth such as the New Homes Bonus. Initially the White Paper sees establishing a TIF Zone as a competitive process to achieve pilot status. It is not clear whether there will be pre-conditions to establish a TIF Zone.

9. Currently, thousands of TIF districts operate nationwide in the US, from small and mid-sized cities, to the State of California, which invented tax increment financing in 1952. California maintains over four hundred TIF districts with an aggregate of over $10 billion per year in revenues, over $28 billion of long-term debt, and over $674 billion of assessed land valuation (2008 figures).

10. The Scottish Government considers that sufficient powers are available there to press ahead with TIF schemes, though secondary legislation would be required. The Scottish Futures Trust has been set up to provide specialist financial and development advice to local authorities and is closely involved with the preparation of these TIF proposals. Several projects to be funded by TIF are now being planned with the leading project being promoted by Edinburgh City Council to support business development in the Port of Leith area UK's first pilot. It is understood that the TIF related infrastructure investment involves new road access and docks/locks refurbishment costing about £80m.

11. The main proposed scheme to date in London is the Northern Line Tube extension from Kennington to Battersea Power Station to serve the Vauxhall, Nine Elms, and Battersea Opportunity Area. The initial development outcome modelling by TFL, GLA, and Wandsworth, is that the Tube extension will enable a denser, more mixed use development with a projected 20/25,000 jobs. Without the extension the area would be developed more slowly and with a less vibrant outcome - more housing, little mixed use, many fewer jobs.

12. The most likely source of funds is local authority borrowing from public or private sector sources. The cheapest source of funding will be from the Public Works Loan Boards (PWLB). Private finance is a possibility, although limited appetite for development risk may require a local authority guarantee to be in place. There is also potential for mixed funding of public or private development finance refinanced through a bond when the cash flows are mature.

13. A key element for a local authority will be certainty of the completed and occupied (occupation is important in rating law) development yielding the anticipated cash flows. As such the local authority may look for completion and occupation guarantees beyond the usual due diligence on cash flows. There will also be risks which feed into completion of the development for example, completion of the TIF funded infrastructure. Local authorities will also seek to secure certainty of cash flows, as will any private funder should this be the route. Risks to forecast cash flows will include, a flawed business plan e.g. including wrong assumptions on the levels of rates, robustness of tax revenue streams e.g. nature of and concentration of occupiers, economic strength of TIF Zone e.g. empty rates relief, movement in rateable values from re-valuation, collection levels and ratings law.

14. Government will need to look at EU procurement law to ensure that funding controls do not amount to "works" and also State Aid rules to ensure there is no aid in the TIF funding through favouring specific undertakings.

15. It is suggested that the establishment of a TIF Zone will include some or all of the following steps; preparation of outline proposals for the TIF Zone, establishing a stakeholder organisation within the TIF Zone to agree proposals probably involving the Local Enterprise Partnership, business case or plan for TIF Zone, designation of TIF Zone, master planning and costings, planning permission and any CPOs, raising of finance whether public or private, a funding agreement with the developer and mechanics for ring fencing the business rates to repay the finance.

16. Development projects aided by TIF are likely to be marginal in terms of financial viability otherwise development would proceed with developers operating on the usual market terms. Such projects therefore carry a degree of risk and the Government is bound to be concerned that future tax revenues are used wisely and that the risk of failure is carried as far as possible not by the Exchequer but by the sponsoring local authorities. Key uncertainties include predicting the timing and scale of development to be enabled by TIF supported infrastructure, and the cost of such infrastructure. TIF financial models have to predict rates revenue streams 15/20 years ahead.

17. The US experience has raised concerns that development has been shifted from areas not benefiting from TIF enabled infrastructure to TIF defined areas (displacement). Financial and other modelling of TIF proposals will need to demonstrate regeneration and quality of development outcome, reasonable certainty of outcome, grip on costs, minimisation of displacement, and the capacity of sponsoring authorities to carry risk.

18. Each Local Authority will have its own special set of circumstances. In the case of Southwark, basic assumptions about business rate growth will have to be made, for example the northern part of the borough has a different

business dynamic to the southern part, and this may influence investment planning.

19. In terms of funding the investment, there will a cost to the Council if it decides to borrow. There is a statutory requirement to cost interest on the average of the total Council borrowing. Thus when making business investment decisions dependent on borrowing, regard has to be given to the Councils average interest rate over all of its' borrowing. This will not be the same as the rate of interest offered by the PWLB for example. In the case of Southwark, the average borrowing rate over all its debt is 6.95%. A further addition to handle prudential borrowing accounting requirements approved by Council as part of the Treasury Management Strategy of 4% (assuming a 25 year depreciation life) makes the accounting rate of borrowing 10.95%. This cost would be in addition to the capital principal repayments, and would be levied on an annual basis.

20. Council assembly approval would be required if prudential borrowing was planned. This would ordinarily be undertaken with the annual approval of the treasury management strategy. The Council would be committing to long term financing of an asset, an action that could be affected by future changes in TIF legislation. Thus the targeting of funds facilitated by TIF to the areas of greatest need within the borough will require a balance between the available resources and outcomes. TIF will not be cost free to the Council, and this cost will remain in some form for many years to come.