Credit Where Credit's Due

Investing in local infrastructure to get Britain growing

Richard Carr

Edited by Alex Thomson

Foreword by Jesse Norman MP

LOCALIS

www.localis.org.uk

LLOYDS BANKING GROUP

About Localis

Who we are

Localis is an independent think-tank, dedicated to issues related to local government and localism. Since our formation we have produced influential research on a variety of issues including the reform of public services, local government finance, planning, and community empowerment. Our work has directly influenced government policy and the wider policy debate.

Our philosophy

We believe that power should be exercised as close as possible to the people it serves. We are therefore dedicated to promoting a localist agenda and challenging the existing centralisation of power and responsibility. We seek to develop new ways of delivering local services that deliver better results at lower cost, and involve local communities to a greater degree.

What we do

Localis aims to provide a link between local government and key figures in business, academia, the third sector, parliament and the media. We aim to influence the debate on localism, providing innovative and fresh thinking on all areas that local government is concerned with. We have a broad events programme, including roundtable discussions, publication launches and an extensive party conference programme.

We also offer membership to both councils and corporate partners. Our members play a central role in contributing to our work, both by feeding directly into our research projects, and by attending and speaking at our public and private events. We also provide a bespoke consultancy and support service for local authorities and businesses alike.

Find out more

Please either email info@localis.org.uk or call 0207 340 2660 and we will be pleased to tell you more about the range of services which we offer. You can also sign up for updates or register your interest on our website.

ISBN: 978-0-9569055-3-6

About Lloyds Banking Group

Our vision

To be the best bank for customers. Becoming the best bank for customers means being the best bank for businesses, for shareholders, for our people and for our communities.

Our strategy

We will put our customers at the heart of everything we do. We are already re-shaping our business so that by working together we can focus all our future decisions around our customers. We are investing all our energies in doing the things we do well, and doing them even better. That means focusing largely in the UK and on those customers and clients who have a strong link with the UK.

How we will make this happen

We will maintain our relentless focus on building strong relationships with customers, enhancing our reputation as the leading through-the-cycle bank. The investment the Group is making is considerable and will have far reaching benefits in expanding products and capabilities for our customers – including finding new and innovative ways to fund Britain's infrastructure. As a result, we are very pleased to be supporting research in this area.

Find out more

Please either email governmentrelations@lloydsbanking.com or call 020 7356 2189 and we will be pleased to tell you more about our work.

Contents

Acknowledgements

Several people have read a draft of this report and provided helpful comments. Thanks for doing so are due to the following council officers and members: Margaret Lee (Essex), Chris Buss (Wandsworth), Cllr Sir Richard Leese (Manchester City), Cllr Mike Jones (Cheshire West and Chester), Cllr Paul Tilsley (Birmingham), and Cllr Graham Chapman (Nottingham). Philip Mind at the LGA has also read and commented upon a draft. Baron Frankal (New Economy Manchester), Dame Nancy Rothwell (Greater Manchester LEP) and Chris Bilsland (City of London) also generously gave up time to talk through some of the issues this report explores. The views expressed by contributors to roundtable discussions at the three major party conferences have helped shape what follows, as have respondents to our survey. Finally, the PWLB provided useful statistical information which helped inform the second chapter. Thanks are due to Essex County Council, Cheshire West and Chester Council and Nottingham City Council for images used in this report.

Localis would like to acknowledge the support of Lloyds Banking Group in helping produce this report.

About the Author

Richard Carr joined Localis as a Research Fellow in July 2011 after working as a lecturer at the University of East Anglia, and a By-Fellow at Churchill College, Cambridge. He worked for the Labour Party in Cambridge during the 2010 General Election and, party political work aside, he has authored a number of academic articles on interwar British politics. He has a BA and PhD in History from UEA, and a MPhil in Modern European History from the University of Cambridge.

Foreword

by Jesse Norman MP, Member of the Treasury Select Committee

We need to think innovatively about the ways in which we fund infrastructure.

On the one hand, cutting the national deficit means that there is less central money to go around, and what remains for investment will be subject to intense scrutiny. But on the other hand, as this report highlights, our "infrastructure deficit" has the potential to be just as serious a problem over the long term.

Roads clogged with traffic, sluggish broadband connections, trains heaving with passengers, a national grid which lacks resilience—the danger is that these are what we bequeath to future generations.

How can we resolve this dilemma? The answer lies in making better use of the weapons we have, and in being bold about adding to our armoury.

Investing in infrastructure offers two huge benefits: it unblocks the arteries of the economy, creating economically and socially valuable assets for the future, and it also provides low- as well as high-skilled jobs and wages right now, at a time when they are much needed. In doing so, it reduces the benefits bill and brings in tax receipt to the exchequer. This is the virtuous cycle that the government is seeking to trigger.

In order to do so it has put in place a range of mechanisms to encourage and assist investment in infrastructure by local government and other bodies. These include Tax Increment Finance and Enterprise Zones, the £500m Growing Places Fund, and the devolution of power and money to local authorities and Local Enterprise Partnerships. Over time, new sources of long-term finance are being targeted and brought on stream. It is a great merit of *Credit Where Credit's Due* that it surveys and assesses all of these opportunities.

As the two recent National Infrastructure Plans make clear, achieving the necessary investment will require capital from both public and private sectors. This report focuses on creating a new public-private partnership which – building on the lessons of the discredited Private Finance Initiative – it argues can achieve this. Local Asset Backed Vehicles and joint-investment models also have great potential to create both low-cost physical infrastructure and a profitable return to the taxpayer.

A key recommendation of this report is for a new investment institution to be created and capitalised by various means, including both public and private pension funds. I have set out my own ideas on the potential of a National Infrastructure Fund. The National Infrastructure Bank model outlined here adopts a rather similar structure – an independent balance sheet of its own, some form of central government credit support at the outset, and, crucially, a mandate to invest directly and help facilitate external investment in the infrastructure that will drive growth in the coming years. At a time where an under-confident but cash-rich private marketplace is coupled with a shortage of public capital, this approach needs urgent consideration.

Overall, this report's conclusions are of direct relevance for central government and local authorities of all political persuasions. It is pragmatic, comprehensive and clear. It persuasively argues for the need to think differently; to embrace new funding mechanisms; to be bold and entrepreneurial in the public service. It deserves to be widely read, and carefully considered.

Executive Summary

The Coalition Government has set itself two ambitious goals: eliminating the budgetary deficit by 2017, and driving over £250bn worth of infrastructure investment. To aid in the delivery of the first target it has substantially cut grant to local authorities whilst retaining central control over many areas of fiscal policy. That said, to help drive forward the second of these ambitions from below, it has legislated – and is legislating – on a series of financial powers due to be given to local authorities in the coming months and years. If used adeptly, these powers have the potential to partially offset the short fall in capital grant (significant though it is), and deliver much needed growth across the country. This report seeks to highlight what these mechanisms will look like, as well as suggesting ways in which they could be best used.

Whilst local authorities have hitherto relied on the Public Works Loan Board (PWLB) to borrow capital for infrastructure investment, the Chancellor's decision in October 2010 to raise the rate at which this institution would lend to authorities has led local government to seek new ways of raising monies for such projects. After surveying the past and evolving landscape, this analysis outlines how authorities may use various tools to help deliver the required infrastructure in the coming years. It also stresses where central government may best play its role, and outlines a new, more equitable public-private partnership (PPP) which can not only contribute to alleviating present economic difficulties, but also deliver a collaborative form of growth that will be of longer term national benefit. This is about recasting the role of local government, from recipient of central funds and dictat, to active and dynamic shaper of our political economy through investing its own capital, and facilitating the most positive use of other forms of finance, both public and private. To do so, following a brief introduction to the scope of what follows, it adopts the following structure:

- Our first chapter outlines the history of local government finance, and the role it has played in delivering infrastructure prior to 2010;
- The second chapter then takes us on to the current landscape, and surveys developments since the Coalition took office;
- Chapter three forms a discussion of the various mechanisms connected to business rate retention, including Enterprise Zones (EZs);
- Chapter four outlines how more effective use of trading powers and asset management may free up funds for future infrastructure;
- Chapter five looks at how growth may be incentivised from the bottom up, and argues in favour of a new role for Local Enterprise Partnerships (LEPs);
- Chapter six addresses new (and returning) borrowing options in detail – and pays particular reference to bonds (and derivatives) and Tax Increment Financing (TIF);

- Chapter seven then sketches out a vision of the future of investment from both public and private spheres, and illustrates the utility of a potential National Infrastructure Bank.

Adopting this structure, this report contends that:

Overall

- Local authority capital requirements will require a range of funding options going forward. The PWLB will remain an important option for local authorities, but only as one of many, and only when its rate is attractive. Refinancing at appropriate times will remain a key component of any authorities' financial strategy.
- Local authorities should not sit passively by whilst change occurs around them, nor simply attempt to protect what funds they currently possess, however tempting that may be. Recovery will require growth, and growth will require investment. This will mean taking sensible risks, and engaging with the Treasury, LEPs and the private sector alike to see where external sources of investment can be obtained.
- LEPs should be given a more dynamic role, and greater explicit powers (detailed below).
- Pension funds (both private and public) should be strongly encouraged to increase their investment in UK infrastructure projects, including via start up funding for a new National Infrastructure Bank, in order to unlock long term, sustainable economic growth for the country.

Within this it makes a number of recommendations, including:

Central government

- Should seek to create a National Infrastructure Bank (NIB), which is given powers to borrow and lend immediately, and thereby facilitate investment opportunities for the private sector along the lines of the Green Investment Bank (GIB), but with a greater remit and capitalisation.
- Should ensure any NIB is capitalised by a mixture of central and local government funds. The Local Government Pension Schemes should be prepared to invest in such an institution, and central government should use the new February 2012 round of quantitative easing, or potentially any wealth tax introduced (particularly a mansion tax), to facilitate this process. We suggest the level of public capital for any NIB should be £20bn phased over four years.
- Should encourage private pension funds to invest a small additional percentage of their funds (at least another 0.5% of total assets) in infrastructure, and particularly any NIB. Using the GIB (and any NIB) to facilitate investments would be a start, but the government can go further. Building upon recent public discourse, it should stress that responsible capitalism involves more than attaining the highest profit margin achievable on a day-by-day basis. Sustainability and the long term matter too.
- Should legislate to reverse the emphasis of Section 42 of the 2003 Local Government Act. This would give the Secretary of State the power to prevent cross-authority Business Improvement Districts, rather than force local authorities to seek their say so for any such scheme.
- Should give LEPs some real teeth – using the 'barrier busting' agenda – with particular attention being paid to LEPs serving as (non-mandatory) formal 'receipt pooling functions' for business rates (NNDR) and Community Infrastructure Levy (CIL) monies.
- Should encourage those Local Enterprise Partnerships without an Enterprise Zone to submit bids for approval. Pending a successful outcome, these EZs

would come online in April 2014. The government should announce its intention that, should the initial round of EZs prove a success, that they would allow LEPs to contain a second EZ from 2018.

- The government should explore permitting the sale of one additional Enterprise Zone and one additional TIF scheme per LEP to the private sector, and introduce any necessary amendments to current legislation to permit this.

Local Enterprise Partnerships (LEPs)

- Have a potentially key role in the new landscape, offering advice to member authorities and helping drive economies of scale across authority boundaries.
- Should seek to serve as a (non-mandatory) 'receipt pooling' function for business rate, and CIL monies.
- Should invite, where they do not currently have such a figure, a leading figure from the financial services industry onto their board to help advise on the new funding options available.
- LEPs should seek to sell an additional Enterprise Zone/TIF scheme (initially limited to one each per LEP) to the private sector.

Local authorities

- Should continue to explore borrowing options both within public and private sectors, and use refinancing to make the most of both.
- Should use Tax Increment Finance to fund current development through future income streams, and identify opportunities for both option one and option two projects (i.e. small and large scale) within their authority.
- Should seek to pool infrastructure related monies (particularly NNDR and CIL) where possible, and look for economies of scale across authority boundaries.
- Should examine whether NHB monies can be used to augment the government's FirstBuy scheme, and help kick start the housing market.
- Should match fund Business Improvement District (BID) schemes where possible, and seek to implement a 3%+ levy to drive forward larger scale projects across authority boundaries where it is appropriate and feasible.
- Should be prepared to see an additional 8.5% of Local Government Pension Schemes' monies invested into domestic infrastructure. 8.5% would equate to over £12bn of new investment, and could be split between individual investments (pending, of course, a sound business case) and helping to capitalise a national infrastructure bank.
- Should take a positive line on Local Asset Backed Vehicles (LABVs) – where authorities provide the land and the private sector the capital towards a given development – whilst seeking to be robust in their procurement practises for such schemes, and seek to offer joint LABVs with neighbouring authorities where appropriate.
- Should explore the use of bonds for long term capital projects, and, given the ability to lower transactional costs and the cheaper rates on offer, seek to enter into a joint bond issue with other authorities for limited projects. Bonds will often most profitably be used in conjunction with short term prudential borrowing due to differing maturities and associated rates.
- Should use land auctions to secure developable plots of land (possibly parcelled together with existing buildings and potentially across authority boundaries) and thereby drive investment into their area.
- Those cities seeking to use CIL as a form of tax increment financing should approach the government to see what terms may be on offer for any 'city deal.'
- In cities that vote for mayors in the forthcoming referenda, those mayors should seek to maximise their powers as to borrowing against CIL, and co-ordinating pan-city BID and business rate supplement schemes.

The private sector

- Should recognise the mistrust created by the early years of the Private Finance Initiative in any dealings with local authorities.
- Should continue to approach local authorities with offers to initiate a Local Asset Backed Vehicle (LABV), which deliver profit for their shareholders and the taxpayer alike.
- Private sector companies should encourage their pension fund trustees to increase their investment in UK infrastructure.

Standout survey results

We sent a survey to every council leader and chief executive across England as to their views on infrastructure finance in the coming years. Precisely 100 responded to various elements of the survey. The following represents a snapshot of our results (to ensure as large a sample as possible, respondents were free to skip questions), and help inform the above conclusions:

- Almost 50% compared to 32% respondents characterise themselves as ambitious rather than cautious in their infrastructure plans.
- Only 17% see the current level of financial autonomy available to local authorities as helpful to their infrastructure plans.
- Transport (75%) and communications (71%) are by some margin the areas of infrastructure authorities are most looking to improve in the coming years.
- Central Government has a key role to play in infrastructure finance. 72% see either bringing forward already scheduled capital investment or central government pump priming the market as the key to unlocking any private sector led recovery.
- A majority of respondents have lobbied central government for more power/ money being devolved for the use of the NHB (64%), Business Rates (67%), and Enterprise Zones (70%).
- Local government will use a range of funding mechanisms in the coming years. A majority of authorities plan to use CIL (81%), the NHB (68%), and European funds (50%) to help meet their infrastructure requirements. Business rates (49%) and the Regional Growth Fund (45%) will likely also play an important role.
- Local retention of business rates is welcome (81%) but almost one in two authorities (49%) would prefer an alternative model to that proposed by the government.
- Though a majority (77%) welcome more private sector involvement in economic development (and no authority outright opposed it), PFI is regarded as a poor potential funding option in the coming years. 68% see it as poor value for money, whilst only 4% offer a positive opinion.
- The most important function (50% indicated) of a LEP is seen to be attracting private capital from outside the authority.
- Though a majority previous experiences of cross authority collaboration have been at least somewhat positive (83%), there is work to do to enshrine greater trust here: 32% see a collective bond issue as unlikely or impossible, although LEPs may have a role to play here. 26% see fostering cross authority collaboration as the LEPs' most important function.

Introduction

The purpose of this report is to illustrate the mechanisms that may help best meet local government's infrastructure requirements in the years ahead, and, more broadly, deliver national economic growth (with associated benefits such as job creation and, in the long run, deficit reduction). With over £250bn worth of infrastructure investment to deliver, a 26% reduction in local authority budgets, and private sector capital still relatively scarce, this is no simple challenge.

To help shape our recommendations in this regard, this analysis surveys both historic and current economic circumstances, before illustrating how effective use of their business rates, local authorities' ability to trade for profit, and new incentives introduced by central government may free up capital for infrastructure investment. We then turn to the role new (including local asset backed vehicles) and returning (such as bonds) funding options may play, before concluding with a discussion of how pension funds and a new National Infrastructure Bank can help drive forward much needed investment.

Before we begin however, it is worth defining the overarching nature of what follows - what we mean by infrastructure, the nature of the borrowing local authorities usually undertake, the survey which underpins some of the conclusions which follow, and a glossary outlining some of the terms used throughout.

Infrastructure

The two recent (2010 and 2011) National Infrastructure Plans outlined five major categories of infrastructure:

- Energy
- Transport
- Digital communications
- Flood management, water and waste
- Intellectual capital

It is the first four of these categories that this report primarily addresses. There are related and important issues surrounding education and skills funding, but these types of intellectual capital merit a separate analysis of their own. The manner in which housing dovetails with the first four topics (through issues such as planning, and the type of financial mechanisms that may help fund it in future years) sees its inclusion in this analysis.

The nature of local government borrowing

Though we discuss the precise mechanisms in detail, it is worth briefly noting the overall pattern of local government borrowing. Firstly, local authorities – like any other borrower – seek to gain the most attractive rate of interest at a given time. Again, as with any transaction, this will mean different rates of interest for different length and size of loans. Prudential borrowing can offer a lower rate than that offered by the PWLB (gilts + 100 basis points), but banks tend to offer their lowest rates at around the five year mark – fine for the up-front costs of construction of infrastructure, but less useful for the lifetime of a thirty year project. Bond markets, as we will note, have their advantages (particularly for longer projects), but their investors tend to have less appetite for non-operation, incomplete assets – again hampering the early development of projects. The European Investment Bank can lend tens of millions of Euros at a low rate (gilts + 50 basis points), but only up to 50% of the total project value. Authorities need to be flexible as to their lending options therefore, and the schemes outlined in what follow help inform this process.

Methodology

This project draws upon a survey sent out to every Chief Executive and Council Leader in England. Precisely 100 such figures responded (from every region in the country and every type of authority) to questions within the survey, and this sample thereby represents a significant snapshot of local government opinion in this crucial area of public policy. Questions were asked on a variety of issues (due to the length of the survey and to ensure maximum response rates, respondents were free to skip questions), and the results are delineated throughout.

We also held roundtable discussions on infrastructure finance at the three major party conferences in September and October 2011 which included contributions from leading local authority figures, parliamentarians, and ministers. This was followed up between October and December with both telephone and face-to-face interviews with some of the attendees of these roundtables, and other local authority and local enterprise partnership figures. The views of individuals from financial and the wider economic sphere were also canvassed during January 2012.

Glossary

This study explores a range of different mechanisms, and therefore uses several acronyms. Below are some of the main terms used:

Abbreviation	Definition
ADZ	Accelerated Development Zone
CIL	Community Infrastructure Levy
EZ	Enterprise Zone
GIB	Green Investment Bank
LABV	Local Asset Backed Vehicle
LEP	Local Enterprise Partnership
LGPS(s)	Local Government Pension Scheme(s)
NHB	New Homes Bonus
NIB	National Infrastructure Bank
NNDR	National Non-Domestic (business) Rates
PFI	Private Finance Initiative
PPP	Public-Private Partnership
PWLB	Public Works Loan Board
QE	Quantitative Easing
RGF	Regional Growth Fund
TIF	Tax Increment Finance

1. The long-term history of local government finance

Chapter Summary

- Local authorities' financial autonomy has steadily decreased over the last century.
- Under the last government, the number of PFI credits issued to local authorities increased tenfold. This has contributed towards a total PFI debt of over £200bn.
- The introduction of prudential borrowing has seen a large increase in private sector borrowing (10%).
- As the recession took hold, local authorities have sought to fund infrastructure through a range (often a combination) of financial mechanisms.

To visit the Britain of the nineteenth or early twentieth century would be to encounter an entirely different model of government. As Tristram Hunt has shown, Victorian cities from Manchester to London were characterised by dynamic mayors trying to emulate the most famous of them all – Joseph Chamberlain – and deliver transformational change to their people. They also possessed the means to do it – in 1870, over 90% of local authority income (both capital and revenue) was raised locally – and through such monies was significant infrastructure delivered. Various Improvement Acts delivered cleaner streets, cleared slums, and provided houses and sanitation systems to cities such as Glasgow and Birmingham, with local authorities stumping up much of the up-front capital themselves, but also attracting in investment from the private sector in something of a proto public-private partnership.[1] Between 1884 and 1914, municipal spending on gas, water, electricity and tramways increased from £8.5m to over £42m. Such improvements were – as the proportion of local authority income raised locally fell to around 70% by the 1890s – reliant upon borrowing; the percentage of local authority borrowing within the total national debt rose from 12% in 1874/5 to almost 40% by 1896/7.[2] Such investments were also intended, it should be noted, to bring a net return to the public purse.

In subsequent decades, Lloyd George and Beveridge may have delivered much in terms of alleviating chronic deprivation, but they also helped usher in a significant decline in the financial power of local government to deliver such Chamberlainite infrastructure schemes. From a situation in 1900 where over three quarters of authorities' income was raised locally, by 1970 this figure was just 60%. The establishment of a National Health Service in 1948 removed some of the burden on local government (and thus accounts in part for the reduction of locally raised monies), but, equally, the creation of a national, mandatory and universal system

1 T. Hunt, *Building Jerusalem: The Rise and Fall of the Victorian* City, (London, 2004), 343-359.

2 Ibid, 373.

of education to be funded by local authorities brought significant challenges given this reduction. A slight recovery in the percentage of monies raised locally was seen in the 1970s, but the broad trend of decline had been established.[3] The Layfield Report of 1976 attempted to redress the balance – advocating local income taxes and the removal of rigid ring fencing of grants – but the presiding Callaghan administration, hamstrung admittedly by the lack of a parliamentary majority, implemented little of its recommendations or in its spirit. By the 1970s, the centre held significantly greater power than it had a century earlier.

1.1 The politics of infrastructure before 1997

During the 1980s the state – local authorities included – was rolled back in several areas to make way for the private sector. In order to help control inflation (rampant during the 1970s) public spending was reduced across the board, including key areas of infrastructure; transport saw an almost 6% decrease in real terms between 1979/80 and 1989/90, and housing – for the reasons below – saw a 67% fall.[4] Though reduced levels of tax receipt contributed to lower investment in several areas, Thatcherite policies such as Enterprise Zones (which included complete exemption from Business Rates for new industrial and commercial premises in 38 areas between 1981 and 1996) did drive growth in previously underdeveloped locations – most famously London's Isle of Dogs.[5] Likewise, the rate of corporation tax (including local taxes) was dropped from over 50% in 1979 to 35% by the mid-1980s, which helped incentivise businesses to invest in the UK, including, both directly and indirectly, its infrastructure.[6]

For several local authorities the 1980s and early 1990s were a controversial time. By reducing public spending the government gave councils control over a larger proportion of their finances. When Margaret Thatcher had assumed the Conservative leadership in 1975, councils were reliant on central government for two-thirds of their spending, yet by her last year in Downing Street this had fallen to 41%.[7] Squeezing budgets and making authorities reliant upon income they could generate themselves was, if controversial, at least not without some logic. There were however two issues with this. The first was the introduction – in response, it should be pointed out, to councils dramatically raising such taxes – of central capping on domestic rates in 1984. Far from its original purpose as a tax on property, which was set, raised and spent locally, over a century of central encroachment instigated by governments of all colours had rather undermined this principle. That said, 1984 was a seismic shift. By giving the Secretary of the State the power to cap excessive council budgets (thus impacting on rates), Thatcher struck a blow against the financial autonomy of local authorities, and their ability to raise their own income. One direct impact of this, ironically, was Liverpool City Council and others spending over their cap, causing a split in the political left, and helping provide a comfortable General Election victory for Thatcher in 1987.

The second major financial innovation that would have consequences for local government finance – both past and, with mind to funding options currently being considered, future – was the stock market 'Big Bang' of 1986. With the aim of arresting the decline in the City of London's fortunes vis-à-vis New York, the government instigated a substantial deregulation of the stock market which resulted in a twelvefold increase (from £2bn in 1985) in the export of financial services from Britain. As capital flowed in and out of the country, local authorities began to seek opportunities to take advantage of this boom. Some, trading prudently, prospered. Yet this was not true of all. In June 1988 the Audit Commission received a tip off that the London Borough of Hammersmith and Fulham had a large exposure to interest rate swaps. In essence, the council had agreed to receive fixed-rate interest payments from a bank, and make floating rate payments to that same institution. Having bet on a fall in interest rates, said rates promptly rose from 8% to

3 T. Travers and L. Esposito, *The Decline and Fall of Local Democracy: A History of Local Government Finance*, (London, 2003), 29.

4 N. Lawson, *The View from No.11: Memoirs of a Tory Radical*, (London, 1992), 301.

5 J. Potter and B. Moore, 'UK Enterprise Zones and the Attraction of Inward Investment,' *Urban Studies*, 37/8, 1279-1312. Albeit at a cost of £17,000 per job for the public purse (and with, it has been estimated, only 58,000 jobs being directly linked to the zones themselves)

6 http://eprints.ucl.ac.uk/14904/1/14904.pdf

7 Travers and Esposito, 50.

15%. Hammersmith and Fulham was not unique in taking such gambles – around 130 authorities entered into contracts with 80 banks between 1981 and 1989 – though they had bet an unusually high amount in one direction. The High Court subsequently ruled that such manoeuvres were *ultra vires*, i.e. beyond the power of the council. As a consequence, the banks involved lost over £500m.[8] Local government hastily withdrew itself from dealings with the financial markets, leading to a period of over 15 years without a bond being issued.[9] Risk aversion was the overriding lesson taken on board by both authorities and banks.

Local authority capital spending as a percentage of total expenditure[10]

- 1970s – 25%
- 1980s – 11%
- 1990s – 9%

With the recession of the early 1990s, and further privitisation of industry such as British Rail in 1994, John Major's administration had kept a tight lid on public spending. Tony Blair, riding on a wave of public opinion that desired an improved transport network and was largely dissatisfied with the condition of the NHS, made much political capital out of hospital 'waiting lists above 1 million' and issued expansive pledges to 'reverse the transport decline.'[11] All this, he seemed to suggest, could not merely be solved by top-down tinkering. As part of his 'stakeholder society,' the then Labour leader thundered against 'the destruction of local government' as being 'one of the most foolish – almost wicked – dogmas of the Thatcher years.' Seeing local authorities as 'central to a regeneration … of government intervention' Blair promised 'more, not less' would be done 'at a local level.' Though, in part, he railed against the rate-capping controversies of the 1980s, New Labour proposed that 'new transport systems, reclaiming derelict land, [and] helping small businesses' would form part of a wider remit of what the 'modern, local government [could] achieve.'[12]

1.2 Labour's regional approach

It all, to some degree, hinged on what one defined as localism. On top of legislating for devolution for Scotland and Wales, in 1998 the new Labour Government created nine separate Regional Development Agencies across England, and capitalised these institutions with funds from six government departments. Charged with (following later extension of their powers) responsibilities for promoting 'sustainable development' and 'further economic development and regeneration,' the agencies were a top-down method of distributing central government and European Union funds to promote (in collaboration with local businesses) regional growth. The differing general financial climate makes any direct comparison between the new Local Enterprise Partnerships (covered in the next chapter) and the RDAs rather difficult, but one can certainly identify a difference in ethos: the distribution of funds under Labour would be from a government imposed body rather than a relatively bottom-up entity.

1.3 Public-Private Partnerships (PPP)

The business involvement on the boards of the RDAs was indicative of a wider trend under New Labour: the increasing role of Public-Private Partnerships. Whilst there have been other forms of PPP, such as joint venture schemes, it has been the Private Finance Initiative (PFI) that has sparked the most debate. PFI, launched in 1992, was designed to spread short and long term risk between private and public sectors. With the private sector assuming a lead role in financing the upfront cost of the construction (or the improvement) of infrastructure, the public sector then reciprocates by making payments to that firm (or firms) for a number of years, often decades. In this way, PFI has provided an increased level of capital projects for a given level of public expenditure, and, in its first ten full financial

8 http://www.ucc.ie/law/restitution/archive/englcases/interest.htm

9 *New York Times*, 6 November 1989.

10 http://www.taxresearch.org.uk/Documents/NEF-PolicyExchange-CapitalFinancing.pdf

11 Ibid, 42, 114. The British Social Attitudes Survey of 1997 – accessible via www.britsocat.com – showed a 50% dissatisfaction rate with the NHS, and 93% desiring improvements to the nation's transport network.

12 Blair, *New Britain*, 220, 314.

years, saw 570 deals being signed off with a total value of almost £36bn. Whilst we will note the specific criticisms of the recent Treasury Select Committee on the issue in more detail later, it is worth noting Jesse Norman's comment that badly negotiated PFI deals 'will hang over the British taxpayer for decades.'[13]

In a rush to – as one Lib Dem council group leader puts it – 'be seen cutting a ribbon in front of a new building,' the New Labour era was marked by some high profile PFI deals which delivered infrastructure in the short term, but locked the public purse into agreements that represented poor value for money over the long run.[14] Norman has pointed to the 1999 building of his local hospital in Hereford as a particularly bad example – where car parking charges have been raised to artificially high levels to fulfil an agreement that contracted out the management of this service not once, but twice, with successive private sector companies instigating a mark-up. Stella Creasy has likewise pointed to foreign firms taking advantage of PFI deals in two ways – firstly in the negotiation of the initial deal, and then, through various loopholes, taking overseas much of the tax that it is presumed were intended to end up in Treasury coffers.[15]

Since PFI keeps most debt invisible to the calculation of Public Sector Net Debt, local authorities (and other public bodies, particularly the Treasury) have had significant incentive to opt for this mechanism. Even through the recent recession, the Labour government oversaw a doubling in the number of PFI credits (formally, a letter from central government to the local authority outlining the amount of private sector PFI investment the centre undertakes to guarantee) from £1.7bn in 2007/8 to £3.7bn by 2010/11. Labour's first three years in office combined, by contrast, had not seen them match even the annual figure for 2007/8.

PFI Credits issued to Local Authorities under Labour[16]

	Amount (rounded to second decimal)	Year	Amount (rounded to second decimal)
1997/8	£0.25bn	2004/5	£1.18bn
1998/9	£0.50bn	2005/6	£0.91bn
1999/2000	£0.80bn	2006/7	£1.70bn
2000/1	£0.71bn	2007/8	£1.70bn
2001/2	£0.56bn	2008/9	£0.57bn
2002/3	£0.68bn	2009/10	£2.21bn
2003/4	£1.25bn	2010/11	£3.75bn

Whilst PFI permitted the politician of the present – both local and national – to take the immediate credit, it would be left to some future Chancellor to deal with the consequence. Yet, it would be remiss to also ignore the positive consequences such jolts to the system had. In 1997, the new Health Secretary Alan Milburn noted that 'when there is a limited amount of private sector capital available, [as now,] it's PFI or bust.'[17] As Kerry McCarthy has likewise recently noted, 118 hospitals would not have been built without the mechanism. Such investment helped produce satisfaction rates in the NHS rising to twenty year highs, and hospital waiting lists decreased by over 600,000 under Labour – significant achievements, albeit at high cost.[18] On this issue of hospital building, it is worthy of note, there was broad political consensus at the time. To Norman, this broad pattern may have some accuracy but it could have been achieved with much lower forms of public borrowing. There are, it is true, lessons to be learned.

1.4 Public Works Loan Board (PWLB)

Since 1793 the PWLB has allowed public bodies (including local authorities) to borrow for capital investment. Throughout the New Labour era there was a heavy,

13 *Hansard*, 23 June 2011.

14 Lib Dem interviewee.

15 *Hansard*, 23 June 2011. 33 deals which generated over £38m in profit, Creasy points out, had accrued only £100,000 in tax.

16 Local Government Financial Survey, No.21 et al. Rounded to second decimal place.

17 http://www.telegraph.co.uk/health/7407484/The-pros-and-cons-of-PFI-hospitals.html

18 http://cep.lse.ac.uk/pubs/download/ea009.pdf

though slowly decreasing, reliance on this institution. In 2001 90% of local authority borrowing debt was owed to the PWLB, a figure which had dropped slightly to 75% by 2010.[19] In large part, authorities' attraction to the loans board is linked to the rate of interest it offers – and, under the last government, this was consistently at a relatively benign level (for a loan over 5 years undertaken from 2005/6 onwards, usually between 3 and 4.5%).[20] At the same time, though it provides a role as lender of last resort, due to the constrained nature of funding options it has historically been the first option for local authorities. That however is showing signs of changing.

1.5 Gradual increases in autonomy – the 2003 Local Government Act and beyond

Though local authorities were no doubt tempted to take their borrowing off balance sheet, the relative decline in PWLB debt cannot be wholly explained by increasing use of PFI, and the 2003 Local Government Act was a significant moment. The 2003 Act provided two major powers it is worth outlining. Firstly, it allowed councils to trade for a profit. In essence extending the wellbeing powers of the 2000 Local Government Act to include the ability for authorities to raise money through discretionary services, it opened the door for local authorities to go, tentatively at first, into business. Several councils took advantage of this opportunity – with Norfolk County Council's various trading companies making a profit of £2m on sales of £84m in 2005/6 and Stockport's Solutions SK – a formerly internal traded service spun out into a wholly owned business – achieving a £40m turnover within two years of its foundation.[21]

Local Authority External Trading Services 2001/2-2009/10 [22]

	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10
Expenditure	£1064m	£1073m	£878m	No data	£734m	£800m	£792m	£829m	£885m
Income	£998m	£1044m	£957m	No data	£1038m	£1093m	£1104m	£1139m	£1158m
Profit	**£-66m**	**£-29m**	**£80m**	**No data**	**£85m**	**£294m**	**£312m**	**£310m**	**£273m**

As the Local Government Financial Statistics (LGFS) illustrate therefore, since the 2003 powers came into force councils have proved ever more willing to make profitable use of business ventures. As they gain ever greater expertise in the market, such trends may well continue.

1.6 Prudential borrowing

Prior to the 2003 Act, local authorities were only able to borrow and offer credit up to levels specified by central government. Whilst still receiving central support for the vast majority of their programmes, from April 2004 local authorities no longer required such approval and were free to borrow so long as they were able to service the debt themselves (for this reason borrowing from foreign currency was still prohibited as exchange rates are deemed too volatile). Prior to 2004, local government capital expenditure could only be financed in one of four main ways – revenue income, capital grant, capital receipt, or borrowing with central government's direct approval. All of these – even, given Westminster's watchful eye being kept on council tax, revenue – were subject to factors beyond local authority control. Prudential borrowing was thus an entirely new factor.

Levels of prudential borrowing – whereby 'authorities must manage their debt responsibly, but decisions about debt repayment should be dictated solely by adherence to the Prudential Code' – have risen sharply since 2005/6. This has largely come, as the table below illustrates, at the expense of councils using their (dwindling) capital receipts, and centrally supported capital expenditure (SCE) borrowing.[23]

19 LGFS No. 12 and 21.

20 *Public Works Loan Board Reports and Accounts 2010-11*

21 http://www.improvementnetwork.gov.uk /impaio/1058295; http://www.apse.org.uk/charging-trading/pdfs/Solutions%20SK%20A%20S95%20Trading%20company%20model.pdf

22 LGFS 12-21.

23 SCE: the amount towards which revenue grant will be received from central government for the costs of borrowing.

Essex County Council's Recycling Centre for Household Waste in Braintree is one of numerous examples of local authority infrastructure at least part funded by prudential borrowing.

Sources of Finance for Local Government Capital Expenditure (% of total) [24]

	2005/6	2006/7	2007/8	2008/9	2009/10
Central Government Grant	23	25	34	28	34
Other (Prudential) Borrowing	13	14	16	21	23
Use of Capital Receipts	17	16	13	10	7
SCE	23	21	14	15	13
Other Grants[25]	8	8	10	10	6
Revenue Financing[26]	15	16	13	16	16

By the end of the last government, a majority of English councils had utilised the new prudential powers – with 85% of shire counties, and over nine in ten metropolitan districts using them in 2009/10.[27] These figures show that demand for non-governmental capital has steadily increased since local authorities were given greater control over their borrowing. It also, as the following indicates, has led to an increased level of capital expenditure even throughout the financial crisis:

Capital Expenditure by Local Authorities[28]

2006/7	£16.3bn
2007/8	£20bn
2008/9	£19.8bn
2009/10	£21.4bn
2010/11	£23.1bn

An increased entrepreneurial ethos has been embraced by councils and with the odd company that has not taken off, going into business has provided a potential avenue for councils to turn a profit, and re-invest these monies, directly or otherwise, into infrastructure. With reference to a key criticism of the August 2011 PFI Treasury Select Committee – that public officials lacked the commercial awareness to negotiate a suitable deal – the skill sets gained through such enterprises may prove of substantive value going forward, particularly in an era where councils are being given ever greater autonomy.

If the 2003 Act liberated councils financially to some degree, councils were not given any greater control over a key income stream – their National Non-Domestic Rates (NNDR). Under the complex system of formula grant of which, by

24 LGFS (2011)
25 Includes Private developers, non-department public grants, National Lottery and European Structural Funds.
26 As in Major Repairs Reserve, Housing Revenue Account and General Fund monies.
27 See the *LGFS* (2011).
28 http://www.communities.gov.uk/publications/corporate/statistics/capital201011finaloutturn

2009/10, NNDR made up around two-thirds the amount – business rates were (and are) pooled centrally before being redistributed in a four stage process. Essentially then, a revenue stream which currently makes up around 12% of annual local government income is one which councils have little or no incentive to maximise.[29] A direct corollary to this, other than engendering a reliance on central government, is to disincentivise local authorities to attract new business. Why, the argument has gone, should authority A seek to attract a firm if authority B gets to share in, or potentially receive more of, the additional NNDR generated.

1.7 Accelerated Development Zones (ADZ) and towards Tax Increment Financing (TIF)

In their final years in office Labour set about confronting this disincentive in a limited form. In the 2009 Budget Alistair Darling announced that the government would explore the use of accelerated development zones (ADZ) where Tax Increment Financing (TIF) would be possible. Councils were asked to submit proposals as part of that process, and positive noises were garnered from Birmingham, Leeds and Newcastle City councils amongst others.[30] This was followed in 2010 with a firm commitment to introduce a raft of ADZ pilots – a process which saw 120 expressions of interest from 80 different authorities.[31] ADZs proposed to allow authorities to retain the entirety of the NNDR increment garnered from any increase in development, and in turn, if used with a TIF scheme, use these future revenues to fund the borrowing towards said development in the first place. By allowing authorities greater access to NNDR, and the ability to borrow against hypothetically increased revenue, the proposals offered a greater degree of autonomy for local authorities, and the means with which to fund future infrastructure. The ADZ pilots would have seen £120m invested 'to help support projects that deliver key infrastructure and commercial development to unlock growth.'[32] Though Labour left office in May 2010, the spirit of the schemes would, as we will see, make it into the Coalition's agenda for government.

1.8 The global slump

Such pump priming was in large part instigated by the global economic slump from the autumn of 2007. Having presided over 44 successive quarters of economic growth both the Labour government in Westminster and authorities across the country were confronted with a very different reality: global economic depression. As the credit crunch took hold and the banks stopped lending, an immediate consequence of this was local authorities finding it harder to sell off (or lease) their assets. Hitherto, authorities had often shown sparks of innovation in this regard. In 2004/5 Leeds City Council sold a 70 acre (underused) residential site for £62.5m, and used the receipt to regenerate a deprived council estate in the south of the city. Similarly, Tower Hamlets' rationalisation of its property services into five sites achieved recurrent savings of £2m, money that was then reinvested into core services.[33] As LGFS data illustrates however, once the economy began to tumble and private capital dried up, this had a significant effect on local authority asset management and the deals they could strike.[34]

	2006/7	2007/8	2008/9	2009/10	2010/11
Capital Receipt	£3.67bn	£3.99bn	£1.35bn	£1.43bn	£1.36bn

Unable to rely on a private sector which increasingly retreated into its shell, local authorities have been forced to rely on help from central government. The proportion of income local authorities derive from central government increased from 60% to 64% between 2005/6 and 2009/10 – and we are therefore almost back at the proportions seen in the mid 1970s.

29 LGFS (2011)

30 http://www.insidehousing.co.uk/councils-bid-to-use-future-taxes-to-fund-development/6505439.article

31 http://www.publicpropertyuk.com/2010/03/24/budget-2010-government-to-launch-tif-pilots/

32 Chris Sear, Tax Increment Financing, House of Commons Library note SN/PC/05797

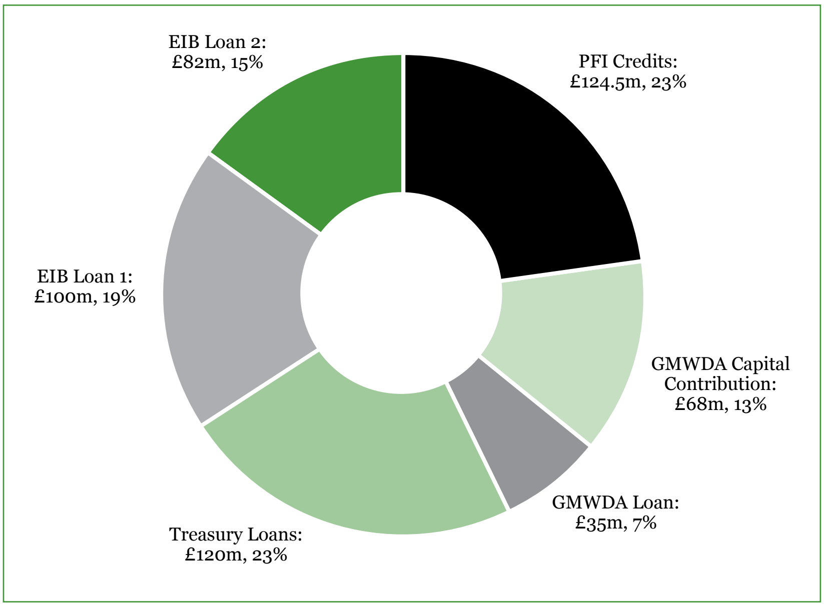
33 http://www.communities.gov.uk/documents/localgovernment/pdf/1180374.pdf

34 LGFS (2011)

Capital projects began to prove particularly hard to get off the ground. As bank credit evaporated Westminster had to resort to self-financing PFI schemes – earning condemnation from both opposition parties at the time – and, though quantitative easing has coaxed the financial institutions to be a little braver – it was (and remains) difficult to fund infrastructure development for local authorities. One successful example of crunch era financing is detailed below:

Greater Manchester Waste Disposal Agency (GMWDA)[35]

In April 2009 an agreement was signed for Europe's largest waste contract to be undertaken in Greater Manchester. The deal, struck through a joint venture between a waste construction and infrastructure investor, stands as evidence that, by being creative in the way they finance projects, local authorities could still make major projects happen in times of economic difficulty. For the £3.8bn project, there was a need for £529.5m of public capital upfront. This involved numerous sources of funding, including two separate loans from the European Investment Bank and active participation from the Treasury – in the form of issuing the PFI Credits and a direct loan.



Through this contract more than 75% of Greater Manchester's waste will be diverted from landfill, thereby helping the UK to maintain its EU environmental obligations. Whilst the Green Investment Bank may provide a lever that was not available in 2009, it is likely deals for the foreseeable future will continue to rely on the type of patchwork framework seen in the GMWDA deal. No one sector will, alone, provide the solution going forward.

Since Labour left office, the volume of new infrastructure building work in the third quarter of 2011 was 0.3% lower compared with the previous quarter – though remaining 13.4% ahead of the same quarter in 2010.[36] In this light, it is likely that similar patchwork deals will play a key role in driving infrastructure investment going forward.

35 http://www.nce.co.uk/greater-manchester-waste-pfi-deal-completed-with-treasury-cash/5200302.article

36 http://www.guardian.co.uk/business/2011/nov/11/construction-sector-downturn-bad-news-for-government

2. Recent trends

Chapter Summary:

- The 2010 Comprehensive Spending Review posed a significant challenge to local authority capital spending – 26% reduction in funding across the board, and a 45% reduction in departmental capital funding.
- Combined with a contraction in private sector lending (-9% for 2009 and 2010 combined), this poses the question of where the money will come from the fund future infrastructure.
- The government has targeted over £250bn worth of infrastructure by 2015.
- To play their part in delivering this, local authorities are being given a range of incentives to build.

In May 2010 the Conservative-Liberal Democrat Coalition took charge of an economy with a £156bn budget deficit.[37] With both parties having made much play during the election campaign out of Labour's perceived economic profligacy, they assumed office pledging to 'significantly accelerate the reduction of the structural deficit through 'reduced spending rather than increased taxes.'[38] In short, spending cuts to maintain market confidence in UK plc (and thus continue Britain's ability to borrow cheaply) was prioritised over the demand led (but slower deficit reduction) focus of Labour's manifesto. By 2015/16, it was pledged, the British structural deficit would be wiped out – a timeline subsequently extended beyond the current parliament by the Autumn Statement of 2011.

The corollary to this reduction in spending however has been a significant – albeit at present somewhat theoretical – extension of the power of local government. Building upon Labour's eventual willingness to cede certain powers away from Whitehall, the coalition government declared it would 'promote the radical devolution of power and greater financial autonomy to local government.' This, the Coalition Agreement added, would include a review of local government finance.

With that ongoing process in mind, this section will make three main points. Firstly, it will illustrate overarching challenges to local government, and how the nature of central government cuts have impacted upon authorities' financial flexibility. Secondly, it will show how the increased localisation of power in the coming years will allow authorities a greater ability to raise capital themselves, and thereby help drive forward the infrastructure projects of today and tomorrow. Lastly, it will set out the case for growth – illustrating the areas where

37 http://www.guardian.co.uk/business/2010/may/21/uk-budget-deficit-smaller-expected

38 http://www.cabinetoffice.gov.uk/sites/default/files/resources/coalition_programme_for_government.pdf

infrastructure is most required – and where there is party political convergence on what should come next.

2.1 Overarching challenges facing local government

There are several constraining factors for local government it is important to flag up before we get to the specifics of recent alterations in grant. Firstly, infrastructure is competing with other important priorities in the coming years. New builds inevitably compete with the need for authorities to carry out basic maintenance of existing infrastructure – of schools, libraries, leisure centres and so forth. Capital spending cannot, therefore, purely be concentrated on new investment. New construction has made up around 70% of total capital expenditure over the last five years, but that has still left – and will still leave – significant sums spent on maintaining current structures. Vehicles, plant equipment and machinery alone, for example, make up around £1.5bn worth of capital spending – no small figure.[39] The economies of scale associated with the cross-authority partnerships, which this report argues in favour of, may help to some extent here.

Secondly, capital spending will have to compete with revenue spending to a large degree. With the cuts to revenue grant, the de-facto capping of council tax (subject to referenda), and the ability to use some of the schemes (such as the NHB) outlined here for revenue purposes, there is the potential for councils to take a risk averse outlook in the coming years – attempting to hold what they have, rather than investing in the future. Plans to devolve council tax benefits whilst top-slicing 10% of the required monies presents further pressures – and there will be a need for authorities to ensure they are collecting council tax receipts from those affected by this 10% reduction in order to fund the types of scheme outlined here. This may bring significant political challenges, but also provides a significant incentive to drive-up local employment, hence the pro-growth, bottom-up nature of what follows.

Thirdly, not directly addressed here but certainly implicit in much of the need for future infrastructure, is the demographic timebomb facing the country. As people live increasingly long lives, and local government is set to take over responsibility for public health for the first time since the early 1970s, this important challenge will increasingly become the concern of authorities. The tendency, again, maybe to stockpile reserves to mitigate against these trends, but a growing economy is another way of dealing with such issues.

This paper is forward-looking, positive and suggestive rather than prescriptive. Yet it would be remiss not to acknowledge that what follows will require bold leadership in face of significant challenges. One of these, clearly, is financial. The October 2010 Comprehensive Spending Review represented a challenging moment for local authorities. The local government financial settlement was reduced by almost 26%, equating to a reduction of around £6.7bn. Capital funding from all government departments to councils was scheduled to fall by 45% over the spending review period (compared to 29% over the whole public sector), with the 60% reduction in capital spending from the Department of Education hitting local authority infrastructure plans particularly hard.[40] In short, funding infrastructure using existing streams was made rather more challenging.

2.2 The increased localisation of power

The Coalition Agreement has committed the government to enacting several policies that have the potential to help partially offset the impact of the cuts in central government grant. Firstly, Clause 1 of the Localism Act arms councils

39 LGFS 2011

40 http://blog.lgiu.org.uk/2010/10/local-government-budget-cut-by-25-6-per-cent-or-6-58-bn-by-2015/; 17% and 11% cuts were also envisaged for Health and Transport respectively.

with a General Power of Competence (GPoC) which gives them (from parish to county council) 'the power to do anything that individuals generally may do.'[41] Whilst the previous wellbeing powers had seen their limitations highlighted by the London Authorities' Mutual Limited (LAML) case in 2008, GPoC is intended to give councils, as the 2010 Conservative manifesto put it, 'explicit authority to do what is necessary to improve their communities.'[42] This open-ended definition gives scope to finance new – and improve existing – infrastructure in a variety of different ways.

Secondly, under the Coalition's general commitment to subsidiarity, powers are being transferred from regional bodies to more local institutions. The newly created bottom-up Local Enterprise Partnerships are replacing the RDAs, with sub-regional groups of councils joining forces with local business to help drive economic growth across the country. Whilst some of the RDA powers are henceforth being led nationally, a significant tranche of their existing responsibilities (and the co-ordination of bids for the new £2.4bn Regional Growth Fund) have been transferred to the LEPs, including helping authorities co-ordinate bids for European Union monies.[43] The September 2011 announcement that LEPs would apply for, and distribute, the new £500m Growing Places Fund has seen their formal role grow of late.

Linked to this has been a localisation of the planning framework. By 'rapidly abolish[ing] the Regional Spatial Strategies (RSS) and return[ing] decision making powers on housing and planning to local councils,' the government has sought to drive development, and thereby growth, from below.[44] This has not been without some criticism – particularly regarding the newly simplified National Planning Policy Framework – but it has certainly localised an aspect of policy that had previously been characterised by a general sense of disempowerment, mistrust, and confusion. Whilst the RSS have been abolished, the Localism Act is set to provide parish councils and community groups with the power to bring forward neighbourhood plans which will sit beneath local plans and offer the chance for residents to shape (albeit small scale) infrastructure developments from below.

Aside from the new NPPF's 'presumption in favour of sustainable development' – certainly set to augur more infrastructure in one form or another – a key ethos of the new planning system is to encourage growth from the bottom up by devolving incentives to the lowest appropriate level. The New Homes Bonus (NHB) – a £1bn scheme (for the entirety of the CSR period) from central government to match any increases in council tax with an equivalent payment to the local authority – will see an 20/80 split between upper and lower tier in two tier areas.[45] This not only provides a potential source of revenue for future infrastructure, but incentivises local communities to approve existing development plans – providing, of course, they 'buy-in' to the proposed use of any NHB monies raised. There are, however, issues surrounding 'winners' and 'losers' from this scheme – which relies upon redirecting any monies above £250m per year from formula grant – which this report will touch upon.

The Community Infrastructure Levy (CIL) is similar. Replacing Section 106 (completely – with the exception of affordable housing – as of April 2014) – whereby sometimes opaque, one-off payments are negotiated between council and developer for approval to be awarded for a given development – CIL 'allows local authorities to…charge a levy on new development in their area in order to meet the associated demands [said development] places and to enable growth.' According to DCLG, the monies raised must be used to 'provide infrastructure – for example new roads and transport' that will ensure

41 http://www.publications.parliament.uk/pa/bills/lbill/2010-2012/0100/lbill_2010-20120100_en_2.htm#pt1-ch1-l1g1

42 In the LAML case the High Court decided that a particular council, Brent, had not sufficiently evidenced how entering into an insurance business would benefit their residents for the well-being powers to apply.

43 Initially £1.4bn. extended in the Autumn Statement of 2011 by a further £1bn in two £500m tranches.

44 http://www.conservatives.com/Policy/Manifesto.aspx

45 http://www.communities.gov.uk/housing/housingsupply/newhomesbonus/newhomesbonusquestions/

the growth produced by a development is 'sustainable [and] will in turn unlock new development.'[46] Some, such as the London Borough of Redbridge are choosing to charge a fixed-rate CIL charge for all types of development – in their case £70 per square metre. Others, like Newark and Sherwood, are adopting sliding scales, and varying the charge for different forms of development: £0-20 for business premises, £100-125 for large retail/supermarkets.[47] Authorities will thus have the power to adapt this particular income stream according to their need. They are at present weighing up the trade-offs between raising revenue and not deterring development altogether. Such incentives for growth will be discussed in our fifth chapter.

If CIL and NHB will provide a new income stream, there has also been some movement on an existing mechanism – National Non-Domestic Rates (NNDR). Our third chapter will deal with this question more directly, but it is worth flagging-up the current landscape. As mentioned, during the last years of the Labour administration there was a growing acceptance that a greater proportion of business rates should be retained locally, and that NNDR could form a way of stimulating growth from below. The July 2011 consultation document on retaining a greater proportion of business rates locally noted how the currently complex formula system does not allow councils to plan their finances with any degree of certainty (thus making non-gilts borrowing more expensive than it might otherwise be), and creates a disconnect between the success (or otherwise) of local businesses, and the state of authority finances. 'This government,' it goes on 'is determined to repatriate business rates.'[48] Enterprise Zones are an albeit narrow instance in which the government has pledged to carry out this ethos to the full. There are, to date, limitations in central government boldness our third chapter will outline, and there may be room to build on such expansive rhetoric. At present, almost one in two authorities in our survey saw the level of financial autonomy held by councils as a hindrance to future infrastructure plans, with less one in six viewing it positively. Change may, however, be afoot.

2.3 The Public Works Loan Board (PWLB) rate change

In October 2010 the Chancellor raised the PWLB by one hundred basis points (1%) over gilts, thereby increasing the cost of borrowing by 25% at a stroke. As part of the government's belief in a private sector led recovery therefore, it has disincentivised borrowing from the state (while enhancing returns from those who continue to borrow from the PWLB), and thereby nudged councils towards private lenders. Into this gap, it seems, may enter increased use of the bond market – an issue our seventh chapter addresses.

We know local authorities are seeking to diversify their borrowing options. The key will be to find the right mix of funding options going forth, and for authorities to act as intelligent consumers in picking the right funding options which balance short and long term need.

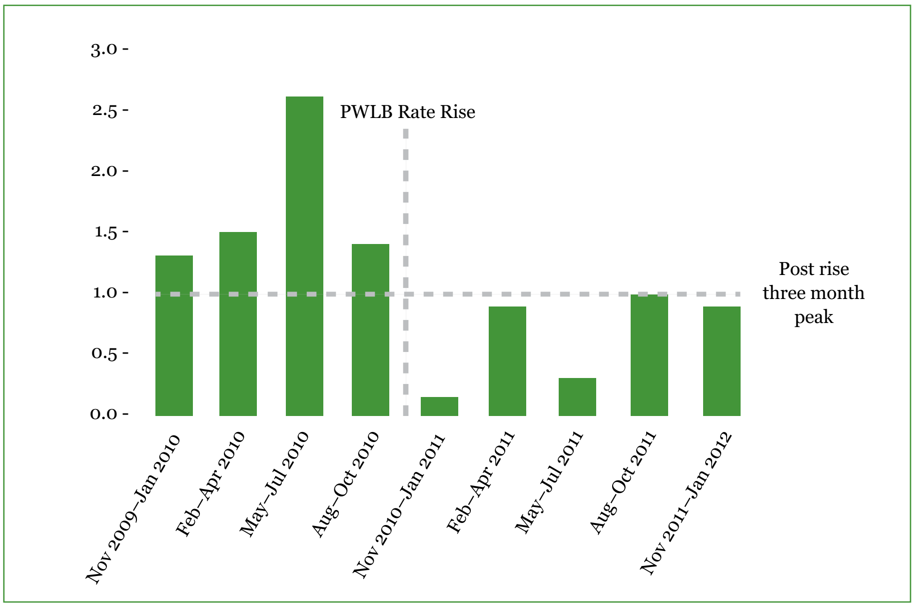
The picture is clearly changing, and the impact of the PWLB rise was initially stark. After the October 2010 rate rise (combined with the December 2010 statement reducing revenue grant, and thereby seeing capital projects take a knock-on hit as monies were diverted to plug this gap), borrowing from the PWLB dramatically tapered off, even compared to the winter of 2009/10. From November 2009 until October 2010, local authorities borrowed around £6.8bn from the PWLB. In the equivalent period the year after the PWLB rise, less than £2.5bn was borrowed – equating to an approximately 64% reduction in authorities using this source.

46 http://www.communities.gov.uk/documents/planningandbuilding/pdf/1997385.pdf

47 See *Planning*, 12 August 2011, 20-21.

48 http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

The Effect of the October 2010 PWLB Interest Rise[49]



In September 2011 however, the Chief Secretary to the Treasury gave councils a potential window of opportunity. To sugar the pill of taking on over £13bn worth of debt from leaving the Housing Revenue Account, Danny Alexander announced that authorities undertaking this move would enjoy a reduced rate of borrowing from the PWLB. Prior to this, a number of authorities had been exploring new borrowing options – principally bonds – with some vigour, and this period of contemplation may have far reaching consequence even given the reduction. Whilst the HRA rate reduces the cost of PWLB loans by 75 basis points (0.75%) – thereby making it cheaper than debt raised through a bond issue – its impact maybe more ambiguous than first thought. Over one in three respondents to our survey indicated the belief that a significant amount of authorities may choose to use the HRA rate for purposes other than the initial debt payment.

2.4 Private sector lending and credit easing

Aside from the recent change to the primary source of public borrowing, there have been significant challenges to securing finance from the private sector. The financial crisis engendered a propensity amongst banks to hoard their capital, and 2008/9 saw local authority long term borrowing from banks dramatically decline (from £1bn in the previous financial year to £321m).[50] A recovery to £616m was seen in 2009/10, but times remain tough. This decline has been mirrored across the board:

Lending to UK Businesses 2007-2010

	2007	2008	2009	2010
Net monthly flow (£ billions)	7.4	3.8	-3.9	-2.1
Three-month annualised growth rate (per cent)	20.9	10.7	-7.7	-5.1
Twelve-month growth rate (per cent)	16.8	17.9	-1.8	-7.1

Given the challenges in securing private sector loans, as we will see, there is a need for local government to explore newer options surrounding the use of pension funds and borrowing against future tax revenues. Central government

49 *LGC*, 10 February 2011. Additional statistics from the PWLB.

50 LGFS 2011

also has a potential role here – either through directly expanding the monetary supply (through Quantitative Easing – QE – which has seen £325bn injected into the economy to date), or facilitating greater lending from banks (Credit Easing). A version of the latter, the National Loans Guarantee Scheme, was announced in November, and has the potential to lower the cost of loans for small businesses by up to one per cent.[51] Critics have argued that QE merely sees banks absorb the money for internal purposes (and thus it never enters the monetary supply), and that Credit Easing will only create £200m of new investment – helpful, but not a step-change.[52] A version of both Credit and Quantitative Easing is discussed in what follows.

2.5 UK Local Government borrowing in European context

With authorities being nudged towards private lenders, the worry is that all roads will lead to the economic situation of Greece or Portugal, but as the following data for 2010/11 illustrates, local government in the UK is hardly approaching such proportions as yet[53]

	Public expenditure – PE (£bn)	Annual borrowing (£bn)	Total Debt (£bn)	Debt as % of PE	Borrowing as % of PE
UK local government	£179bn	£10bn	£70bn	39	6
Greece	£95bn	£20bn	£274bn	288	21
Ireland	£86bn	£41bn	£123bn	143	48
Portugal	£74bn	£14bn	£134bn	181	19
Italy	£652bn	£60bn	£1535bn	235	9

Even in present financial conditions therefore, there is room for English local government – particularly with the forthcoming mechanisms this report outlines – to borrow to invest in the infrastructure that can deliver jobs in the immediate term, and sustainable growth over the medium to long run.

2.6 The case for growth

The UK's infrastructure requirements over the coming years are legion. On top of having to clear a £156bn deficit, the Coalition has set itself the task of facilitating some £250bn worth of infrastructure through 'smarter use of public funding, improving private sector investment models, encouraging new sources of private capital and addressing the nation's regulatory failures.'[54] The private sector is to bear the brunt (approximately 70%) of creating this future growth, which is intended to be mostly built on investment in energy (£118bn), transport (£89bn), water (£21bn) and communications (£20bn) sectors.[55]

The nation's infrastructure is in need of something of a step-change. 40% of London's water mains are over a century old, whilst a recent survey of business leaders revealed widespread concern regarding future energy supply and a transport network perceived once again to be in relative decline.[56] Any future investment cannot merely maintain the status quo. In 2009 alone China invested $103m into its railways, Brazil has announced a three year programme (2011-14) which will see $560bn pumped into that nation's infrastructure, and numerous countries are making judicious use of (mostly foreign) sovereign wealth funds to deliver levels of development above and beyond current British plans. In 2010 the World Economic Forum ranked the UK only 33rd for the

51 http://www.hm-treasury.gov.uk/d/national_loan_guarantee_scheme.pdf

52 http://www.guardian.co.uk/uk/nils-pratley-on-finance/2011/nov/29/20bn-credit-smes-national-loan-scheme-comment

53 *LGC*, 10 November 2011.

54 Lord Sassoon foreword to the National Infrastructure Plan 2010.

55 National Infrastructure Plan, 2011.

56 http://www.businessgreen.com/bg/news/2107949/uks-neglected-infrastructure-putting-investors

quality of its infrastructure and 12th for overall competitiveness, compared to 9th in 2005. The UK was ranked 35th for its quality of roads (below Lithuania), and 19th for railroads (below 10 EU nations).[57]

To stay competitive the UK will clearly need a dynamic lead from central government, and, though local government focused, this report makes some recommendations in that regard. Certainly, any investment cannot be merely targeted on keeping the UK on an even keel – even if, in the short term, such caution would allow the clearing of the current deficit. The danger of false economies is a perennial problem, but particularly acute at present. Congestion on the nation's roads is predicted to rise by 2025 – and if left unchecked could waste an extra £22bn worth of time, and increase business costs by over £10bn a year. Similarly, it has been estimated that there will need to be 250,000 houses built per annum to keep up with projected population rises over the next two decades. This figure was not met in the last two years combined. Investment has to be found now, or government both local and national will pay later. Decades of under investment in various areas of infrastructure by successive governments has left the UK economy in a difficult position. To get real benefit from any investment in infrastructure, the UK needs to be ahead of the technological curve, rather than decades behind. Broadband is an area where there is a danger of providing out-of-date technology at significant cost, a gap that will of course only grow as other nations invest in capabilities for the world of 2020 rather than 2010. The length of time it has taken to get a (even with the January 2012 go-ahead for the London-Birmingham tranche, still rather truncated) high-speed rail capability in the UK outside of the Eurostar route should form a powerful warning of the dangers of getting behind the curve. The French TGV and Japanese bullet trains are a monument not only to their country's endeavour, but comparative British under-investment.

If the major parties differ on its scale, there is broad political consensus that capital investment needs to be brought forward. In September 2011 the Deputy Prime Minister declared there needed to be a 'gear shift' in infrastructure projects.[58] Pointing to high-profile developments which have overrun – such as the improvements to the West Coast Mainline (intended to cost £2bn and finish in 2005, but cost four times that amount and was only finished in 2008) – Nick Clegg urged the government to use investment as a sign that the current administration was about more than just cuts, and declared that no Whitehall department should be 'stockpiling capital that can be put to good use today.'[59] Speaking on the back of the announcement of a £950m tranche of RGF money in October, the Prime Minister promised an 'all-out mission' to kick-start infrastructure projects and revive the economy.[60] Whilst he and David Cameron differ on much of the detail, Ed Balls' five point plan for growth, announced at the 2011 Labour Party conference, included a similar commitment to 'genuinely bring forward long-term investment projects – schools, roads and transport – to get people back to work and strengthen our economy for the future.'[61] This report forms a hard headed analysis of how local authorities can maximise current circumstance. It is not a forensic interrogation of the rights and wrongs of central government policy, but rather a study in how authorities are adapting to the changes underway, and what options they could and should have to fund future development. It illustrates how adapting to the new financial options available can help deliver the required infrastructure needs at a local level, but also where local government may press for greater action from the centre, and an evolution in the role of the private sector.

57 http://www3.weforum.org/docs/ WEF_obalCompetitivenessReport_2010-11.pdf

58 http://www.guardian.co.uk/politics/2011/sep/13/nick-clegg-gear-shift-spending

59 *Daily Telegraph*, 14 September 2011.

60 http://www.bbc.co.uk/news/uk-politics-15517180

61 http://www.telegraph.co.uk/news/politics/labour/8789445/Labour-Party-Conference-Ed-Balls-speech-in-full.html. VAT is an interesting issue though, for reasons of brevity, not touched upon in this analysis.

3. Using Business Rates

Chapter Summary:

- NNDR is worth c.£20bn per year (30 times CIL), but local authorities currently have little opportunity to borrow against it.
- The Local Government Finance Bill proposes to localise a percentage of NNDR, but will determine this percentage centrally (to ensure deficit reduction targets are met), and not allow authorities to keep real growth (since the percentage will be determined in advance).
- That said, the new Enterprise Zones do allow authorities to keep real growth of NNDR within an agreed area, and should, we argue, be a feature of every LEP.
- Tax Increment Finance also has much to offer, and has levered in investment in Scotland.

Clearly, if over £250bn worth of infrastructure is going to be built, someone will have to fund it. As Nick Clegg noted in a speech to the LGA in 2008, Britain has the second most centralised taxation system in Europe – second only to Malta.[62] On average, local authorities currently raise 47 per cent of their revenue spending locally.[63] Yet if local government has hitherto relied on the centre for much, as the current administration both cuts central revenue streams and devolves a raft of powers to local authorities, times are clearly changing. One of these powers is the control of National Non-Domestic Rates (NNDR) and, as we noted in the introduction, there has been growing consensus that local authorities should be able to keep a greater proportion of their NNDR. This chapter delineates the ramifications this may have for funding infrastructure going forward.

3.1 Current reforms to business rates

From July to October 2011 the government consulted on a range of options regarding greater local retention of business rates. In doing so, it confirmed its four key principles for reform were as follows:

- To build into the local government finance system an incentive for local authorities to promote growth over the long term;
- To reduce local authorities' dependency upon central government, by producing as many self sufficient authorities as possible;
- To maintain a degree of redistribution of resources to ensure that authorities with high need and low taxbases are still able to meet the needs of their areas; and

62 http://www.lga.gov.uk/lga/aio/772667

63 http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pd

- Protection for businesses and specifically, no increases in locally-imposed taxation without the agreement of local businesses.[64]

This, then, is something of a tightrope. On the one hand, those authorities in a position to grow their NNDR receipt are being encouraged to do so. On the other, they will find such growth capped through the need to redistribute NNDR across the country. Tentative modelling has shown that, under a system where all business rates were retained locally, around 40% of local authorities would experience real-terms grant cuts, whilst 10% could see funding grow at more than 2% above inflation.[65] The government is understandably not keen to go this far, yet it has experienced pressure to go further than its initial proposals suggested. Whilst it was estimated that the Treasury 'set aside' envisaged in the July-October 2011 consultation could be as much as £3.5bn (around a sixth of the total NNDR receipt), the government announced in December that this would be scrapped in favour of allowing authorities to retain a percentage share of business rates from the outset of new scheme.[66] Legislation, indicated below, is in the offing:

Local Government Finance Bill

This legislation, due to take effect in April 2013, proposes to:

- Return (for the first time since 1990) a fixed percentage of business rates revenue to local authorities, with money set aside for those authorities which suffer a disproportionate loss (due to the departure or closure of a key local business)
- Retain within government control the power to adjust the percentage of NNDR retained locally (to maintain long-term affordability)
- Localise council tax benefit (top-sliced by 10% – around £420m)

Though the spirit of the bill is generally welcomed by the local government sector, we await guidance on the precise nature of the centrally retained percentage – the magnitude of which will have important ramifications for local authorities' ability to fund infrastructure investment. The Government's consultation response has also referred to 'agreed spending control totals' [between central government and local authorities] being a pre-requisite of local retention. These twin objectives may help the centre keep greater control over immediate deficit reduction, but, importantly, will both be based on a pre-determined central forecast. The scheme as it currently stands will not therefore, for 2013/14 and 2014/15 at the very least, reward real growth.

There are two issues of relevance here. The first is the direct point about local authorities controlling a larger pot of money (or not, as the case maybe in certain instances). Whilst NNDR makes up the bulk of formula grant (and by 2014 it will cover it entirely) – used to fund a variety of local services from the local environment to adult social care – these monies, unlike much of Local Authorities' specific grants, are not ringfenced and could therefore be used to develop local infrastructure. There is also of course an interdependency between capital and service expenditure – there is no point building a nursery if you cannot afford to employ the staff that will run it, and more capital expenditure, if it is to be sustainable, will need to move hand in hand with the capacity to fund associated services.

Business rates may therefore form part of the solution – particularly given the benefits businesses enjoy from improved infrastructure, and their greater

64 http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

65 http://www.lgcplus.com/briefings/corporate-core/finance/size-of-treasurys-business-rate-clawback-could-rise-to-35bn/5036369.article

66 The set aside is designed to ensure local government stays within its spending limits for the rest of the CSR period (business rates are forecast to outstrip what has been allocated to local government in the coming years).

willingness to contribute to such schemes (as Business Improvement Districts and the Crossrail scheme, both illustrate).

Survey Results: Business Rates

Over two-thirds of respondents to our survey indicated that their authority had actively lobbied central government for business rates to be retained locally. Likewise, almost three-quarters could see them playing a role in funding infrastructure – with half indicating this was either likely, or had already been planned for.

It is important to set out the scope of what the government's reforms will mean. As something of a guideline, in 1999/2000 local authorities' net NNDR yield was £12.4bn. Ten years later this figure was £20.6bn, a 66% increase. Though the government is proposing to adopt damping measures to ensure disproportionate growth/loss does not adversely affect particular authorities, it will allow authorities to keep a (as yet undefined) significant proportion of rates within the authority that raises them. Though the 66% rise between 1999/2000 and 2009/10 will be difficult to match in current economic circumstances, the 'aspiration' is to avoid resetting the top up and tariff mechanisms used to calculate each authorities baseline (above which growth can be kept) for a decade, thereby providing a significant new pot of money to both invest directly and borrow against.[67] There will be regional variation in benefit but it is clearly in the best interest of all areas of the country to make the most positive use of the reforms.

The pooling of business rates has been much discussed of late – including in Essex CC's recent publication on the *Future Council*.[68] We will cover this issue in more detail when discussing CIL, but the type of cross-authority schemes that we advocate would benefit from the formal pooling of business rates. With greater (albeit limited) autonomy after years of struggle, it may prove difficult for authorities to cede power over their rates to, as the December 2011 *Unlocking Growth in Cities* prospectus (which unveiled the 'City Deals' offer outlined later) suggested, their LEP. Pooling of business rates should be encouraged, if possible through the addition of central government monies (as was mooted in an initial draft of *Unlocking Growth*), but there are challenges here. LEPs, as with CIL, should be given the power to set up a formal pooling mechanism for NNDR receipts, and encourage local authorities to voluntarily contribute through the identification of attractive schemes for such monies.

Recommendations:

- **Local authorities should continue to make clear that the more significant the percentage of business rates they retain, the more expansive their infrastructure programmes can be.**
- **LEPs, as with CIL, should be given the power to set up a formal pooling mechanism for NNDR receipts, and encourage local authorities to voluntarily contribute through the identification of attractive schemes for such monies.**

67 See DCLG, Local Government Resource Review – Proposals for Business Rate Retention, December 2011, for all this.

68 Essex County Council, *Future Council: The Role of the Local Authority in a Changing Public Service Landscape*, (Jan 2012), pp.36-37.

3.2 Enterprise Zones (EZs)

Whilst there is a debate over how much of their NNDR receipt local authorities should retain, there are other ways business rates can be used to attract infrastructure investment, and the first of these is through the use of Enterprise Zones (EZs). In the 1980s many EZs were located in rural areas with little semblance of becoming, or even gaining significant connectivity to, major economic hubs. EZs announced in August 2011 include locations such as the Humber Estuary Renewable Energy Cluster, Daresbury Science Campus in Halton, and Science Vale UK in Oxfordshire – areas with links to bustling or developing economies, and therefore more likely to attract new business and infrastructure investment.[69] There are currently 24 EZs across the country, a figure which could – and we argue should – be extended.

The key test here, as with TIF, is whether EZs can create genuinely additional growth. The government contends that 30,000 additional jobs can be created by 2015.[70] Critics argue that businesses may well move to the EZs, but only through relocating existing offices (and therefore business rates), and not adding anything extra to the economy. This, as we noted, was a key criticism of their previous incarnation in the 1980s and early 1990s.

The Boots Enterprise Zone in Nottingham (right) aims to create up to 10,000 new jobs

All EZs will benefit from a business rate discount of up to £275k per business over a five year period (starting April 2012), the retention of all business rates growth for at least a 25 year period (commencing April 2013), faster broadband, and lower levels of planning control.[71] EZs are useful in that they attract business but also, crucially for infrastructure, provide a guaranteed income stream for a sustained, period far in advance of other recent government initiatives such as the New Homes Bonus (currently scheduled to last 6 years) or the proposed NNDR settlement (where the re-set mechanism, though ensuring authorities will not experience unacceptably disproportionate growth, does provide a check on predictions regarding long term levels). With local government borrowing, be it via the PWLB, bonds, prudential loans or through PFI normally being repaid over a period of several decades, long term guaranteed income streams are of substantive importance. Enterprise Zones go some way towards ensuring LEPs can experience these. They should seek to maximise the relative certainty of income they bring.

69 http://www.communities.gov.uk/news/newsroom/1967595

70 http://www.bbc.co.uk/news/uk-england-14552193

71 http://www.communities.gov.uk/documents/localgovernment/pdf/1872724.pdf

Our final chapter will touch on discussions regarding the private sector buying an Enterprise Zone, an idea that has been mooted, but not always had its implications fleshed out. For now, it is important to note that not every Local Enterprise Partnership has its own EZ. 11 LEPs had bids passed over in the August 2011 round of EZ allocations – thereby meaning Heart of the South West, Coast to Capital, Greater Lincolnshire and Cumbria, amongst others, lack the benefits an EZ can bring. The government was understandably eager to ensure that competition between LEPs drove a higher standard of bid, but it should also encourage those LEPs that failed in August to come forward again. If LEPs are to have real teeth, Enterprise Zones will play a key role. The government should announce its desire to see all LEPs contain an enterprise zone, and allow those LEPs without an EZ to bid for one to commence in April 2014.

Recommendations:

- **The government should encourage those Local Enterprise Partnerships without an Enterprise Zone to submit revised bids for approval. Pending a successful outcome, these would come online in April 2014.**
- **Should the first round of EZs prove successful in driving additional growth in the next five years, the government should look to create a further round in 2018.**

3.3 Tax Increment Financing (TIF)

TIF, due to be introduced in April 2013, has the potential to significantly augment existing funding options for infrastructure in certain locations. To borrow against a future uplift in business rates caused by a development (or potentially CIL monies), a local authority will need to evidence at least two things. Firstly, they will need to evidence pent up demand to invest in the TIF area – i.e. that a rise in business rates will actually materialise. Secondly, that they have suitable certainty of their future income to meet prudential borrowing rules and raise the up-front funds for development.[72] TIF is also likely to hinge on some form of a 'but for' test – in that it will have to be shown that, without TIF, a given infrastructure development would not occur. There is therefore something of a tightrope to be walked – local authorities will need to show that a given development would not occur without TIF but that, equally, with the mechanism in place a significant uplift in business rate revenues will come to fruition. By diversifying their borrowing options – and thereby securing the best possible rate of borrowing to fund the TIF scheme – councils can lower the amount of NNDR required to finance the up-front borrowing. This may involve elements of PWLB, prudential borrowing and even, as in the United States, TIF bonds (whereby investors put up capital to eventually receive a share of the tax revenue a TIF scheme proposes to accrue). We turn to a version of this latter point in chapter six.

TIF will likely see the best returns where authorities, in conjunction with their LEP, have identified areas of high growth potential. A linking road, as in the above example, is one such instance. We will turn to the potential future mechanics of TIF and where the private sector may come in in chapter six, and instances of cross authority collaboration in chapter seven.

72 http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

TIF in Scotland

The Scottish Parliament has agreed to support up to six pilot schemes to explore the utility of TIF.[73] In March 2011 North Lanarkshire was granted provisional approval by the Scottish Government to develop a major brownfield site, Ravenscraig.

As part of the TIF lodged with the Scottish Futures Trust – a Scottish Parliament quango – a new seven-mile-long dual carriageway will link the M8 and M74 motorways. The road will open up numerous business and commerce activities in North Lanarkshire, and lead to significant residential renewal. Under the TIF scheme, North Lanarkshire Council would be allowed to borrow the capital needed to complete the link. Business rates raised from the new town centre at the former site of Ravenscraig steel works will be ring-fenced and used to repay the costs. TIF funding will lever in £425m of private sector investment in the initial six years of the project, and more than £1.2bn over its three decade duration. It is projected to create over 12,000 jobs.[74]

73 Scottish Government, http://www.scotland.gov.uk/Topics/Government/Finance/18232/TIF

74 North Lanarkshire Council, 'Development boost for Ravenscraig,' http://www.northlanarkshire.gov.uk/index.aspx?articleid=20697

4. Asset Management and Trading Councils

Chapter Summary:

- Councils have used and continue to use their assets to generate income streams.
- Profits from externally traded services have risen almost fourfold in under a decade.
- Land auctions, if used creatively with re-zoning, can lead to large gains for authorities – both in terms of raising profits and delivering infrastructure.

As noted, councils are already attempting to 'sweat' their assets as much as possible in order to free up money for development. Through the General Power of Competence (GPoC) in the Localism Bill – which seems to augur greater trading powers than those enjoyed under the wellbeing era – authorities will have even greater potential to do so in future. The greater financial freedoms offered under the current government also present the opportunity to engender a skill-set which may lead to an even more financially autonomous local government sector, and help arm authorities in future dealings with the private sector. Over half the authorities who responded to our survey suggested that they believed their council would act in a more entrepreneurial manner as a result of the GPoC. This enhanced commercialism will mainly take two courses – the management of their own physical assets, and the profit they can derive from their business ventures.

4.1 Asset management

There are two key ways council assets can play a role in driving future infrastructure. The first concerns the type of public-private partnership we discuss in chapter seven – where local authorities can put up the land, and the private sector the money, for a joint venture. Underused land and, currently, underutilised private sector capital can be combined in some form of long standing partnership. The second builds upon previous practice – and the entrepreneurial spirit of the 2003 wellbeing powers – and illustrates examples where councils have managed their estate in a more creative fashion.

In August 2011 DCLG released a list detailing the more than £100bn annual running costs incurred on the £250bn worth of council assets.[75]

75 http://www.bbc.co.uk/news/uk-politics-14405557

Councils own nearly 100 golf courses, 20 cinemas, and 30 sports stadiums. Selling off assets clearly has its limits (some assets, the Etihad Stadium in Manchester for example, are significant earners for the council and bring in large revenues in their current usage), but in order to address the 60% five year decline in capital receipts outlined in chapter one, together with external pressure being brought to bear on councils as regards employees' pay, there may be further room for manoeuvre here. Cambridgeshire, Hampshire, Worcestershire are all scoping further rationalisation of assets – with the first aiming to save as much as £200m over the next decade.[76] Lincoln City Council have also identified the New Homes Bonus as a potentially lucrative method of achieving a double win – by selling underutilised council land to a housing developer, their 2011 management strategy suggests, they may achieve not only the receipt from the original sale, but match funded council tax revenue in future years.[77]

There are of course potential barriers here. Firstly, getting two council departments to agree, in effect, a physical merger can be difficult. Secondly, asset management requires a level of strategic vision not always possible in times of economic uncertainty – once sold council assets remain sold, and thus it is imperative to get any deals right. Yet there are some emerging examples of best practice.

Birmingham's Working for the Future Programme

As part of the City Council's Business Transformation Programme, launched in 2006 and designed to save £1bn over a decade, the Working for the Future Programme intends to deliver a better customer experience, lower property operating costs, greater sustainability, and improved workplaces through rationalisation of property.[78] Having evaluated their entire estate, the council is looking to streamline 55 administrative properties into a total of 9 – and use the sale of the 46 properties to fund the regeneration of key strategic sites.[79]

One such redevelopment has occurred at the Lancaster Circus office building in the city centre. The new building, completed 20 weeks ahead of schedule, has increased employee capacity at the site from 800 to 2,000. The construction firm used was chosen, in part, because of its commitment to local labour and spend – 93% of monies spent on the project were with local businesses, and 120 jobs were sustained over the 14 month project.

By thinking strategically about what assets they require, and how they can be best maximised, councils can increase both the available land for development, and the capital they can put toward such ventures. In London, Barnet, Bexley, Camden, Southwark and Tower Hamlets councils have all made some strides in this regard.[80]

There are also ways, it should be noted, where councils can use infrastructure improvement to trigger greater asset rationalisation, rather than the other way around. Cheshire West and Chester has placed great emphasis on repairing their roads because (other than the benefits to road users and the wider economy alike) it will enable them to reduce claims from drivers hitting potholes,

76 *LGC*, 28 July 2011.

77 http://www.lincoln.gov.uk/Info_page_two_pic_2_det.asp?art_id=8746&sec_id=3004

78 http://www.wates.co.uk/news/lancaster-circus-refurb-completes-20-weeks-early-563

79 Birmingham City Council interview.

80 http://www.guardian.co.uk/local-government-network/2012/jan/23/local-authorities-own-property-portfolio

and lower the volume of calls they receive regarding such instances (thereby reducing the need for particular council owned administrative properties which are therefore leased out or sold off).

Cheshire West and Chester fixed over 3,600 potholes across the authority during 2010/11

4.2 Trading Councils

Though they have enjoyed powers in this regard since the 1970 Goods and Services Act (and the 1970s saw the running of several successful local lotteries by various authorities), Councils' ability to trade effectively has, as our first chapter noted, grown steadily since the wellbeing powers of 2000. From a £66m loss in 2001/2, to c.£80m profit in the mid 2000s, in recent years councils have raised around £300m annually from their external trading services. Some authorities – including Cambridge – have begun lending to other councils (almost always at a lower rate than the PWLB), and with the challenges facing district councils in the coming years, this trend may well continue. As our second chapter outlined, Norfolk and Stockport are but two authorities to have traded successfully since the increase in autonomy over the last decade. Another successful example is in Kent where the county's Commercial Services trading arm (which sells a range of goods and services to other public bodies) has brought in annual dividends of over £6m to the council, and is estimated to help reduce council tax bills by over 1% a year.

Beyond good services, where all this goes next is something of an open question. One new mechanism being piloted is land auctions. The difference between land with planning permission and land without is substantial. By announcing their intention to build, and inviting landowners to name their price for their land, councils could purchase, re-zone and then sell off a plot to a developer. Given the profit such a scheme could accrue, it could be used for either a standard CIL incurring scheme or, alternatively, not (i.e., in this latter case, affordable housing). The scheme is advantageous in that it allows the local authority the room to call the shots. It also has the benefit that it could be combined with the LABVs mentioned in chapter seven, and would allow local government to maximise its role as market shaper. Presumably such a competitive mechanism would also drive down the cost of land acquired. Councils should be thinking in an entrepreneurial sense about how this new mechanism may be best used – possibly, particularly in rural areas, in a cross authority manner.

Recommendations:

- **Local authorities should evaluate their entire estates and see if they are able to achieve 'double wins' – through the sale of assets and subsequent flow of New Homes Bonus/Community Infrastructure Levy monies from these sites.**
- **Land auctions should be used to raise both capital for authorities and sustainable development tailored to community need. The LABVs outlined in chapter seven will also play a key role in any new public-private partnership, and an equity stake in such a vehicle may, as we will see, prove more useful than any up-front income.**

5. Incentivising Growth from the Bottom Up

Chapter Summary:

- Councils have a long record of working well together, but fears regarding cross-authority collaboration remain.
- Local Enterprise Partnerships, though currently limited in scope, offer a new way for authorities to work together, and particularly to pool receipts
- The New Homes Bonus (£1bn over six years) may be used to inject monies into local FirstBuy schemes, and thereby enable local authorities to kickstart the housing market.
- The Community Infrastructure Levy (£6-7bn over a decade) offers a potentially new (and fully localised) stream for authorities to borrow against for future development.
- The City Deals announced in December 2011 provide an avenue for those cities that wish to have a directly elected mayor to maximise CIL borrowing. Other mechanisms may also benefit from cross-authority coordination, such as Business Improvement Districts.

If increasing revenue through taxation or various forms of trading can help provide funds for development, there are ways in which growth can also be encouraged from the bottom up. The coalition has made great play that this should be so, and there are significant benefits to be realised here. Localised power over growth is coming in three forms – the new LEP structures, increased incentives for communities to approve new developments, and the devolution of powers through the 'City Deals' agenda. We take these points in turn.

5.1 Local Enterprise Partnerships (LEPs)

LEPs, at present, have little formal power (the ability to apportion an Enterprise Zone has been a rare exception to date), and no accounting regime. As we noted, they have assisted in the preparation of Regional Growth Fund bids, and advised on the location of their local enterprise zone. These decisions aside, their role to date has been rather ad hoc. Some partnerships have appointed large boards (the South Eastern LEP has 43 members), whilst others have provoked accusations that they will replicate the RDAs unwieldiness, whilst operating on a comparatively shoestring budget.[81] The '£30-40k' used as start up money for some LEPs, as one Midlands councillor put it, 'barely funds a PA and a desk.'[82] Tellingly, 7 in 8 authorities we surveyed are still planning to make investments primarily on their own, rather than through their LEPs.

Survey Results: What are LEPs doing?

One third of our respondents have plans in place to consult externally on various new financial mechanisms. Only one in eight, as mentioned, will make investments primarily through their LEP. 57% of authorities were happy with the geographic size of their LEP, with 38% expressing dissatisfaction.

As touched upon in the second chapter, there is an issue of trust that does need to be overcome here. Local authorities, understandably, are likely to be protective over their budgets and any LEP based partnership needs to be equitable. Yet, there are plenty of good examples of councils working together. Greater Manchester's Transport Investment Fund is made possible by 10 local authorities combining to fund 60% of this scheme locally. Greater Manchester, with its formalised structure and long history of collaborative working is something of a unique case – albeit the city region agenda may change this in the coming years – but there are plenty of successful examples of local authorities working together. Bracknell Forest, Reading and Wokingham councils have joined forces to improve waste management across the three authorities, and have achieved over 97% satisfaction rates with both their new recycling and waste facilities (build through a PFI scheme).[83]

LEPs provide a potential vehicle for a range of funding options we will address in more detail in the following chapter. Bonds which – outside London, Birmingham and a few other councils – will necessitate cross authority collaboration to mitigate against the risk of default and secure an attractive rate are one mechanism where LEPs can play a powerful co-ordinating role. They may also, down the line, serve as a structure to help pool receipts. Whilst their formal powers are currently limited – and the Growing Places Fund (see chapter seven) is addressing this – they have a potentially crucial advisory role, and can connect private and public sectors ably. When interviewed for this process, even councils led by supporters of the previous government have acknowledged that there is no point looking back with fondness for the Regional Development Agencies – getting the structure of the LEP right is a far more pressing question.

Survey Results: What should LEPs do?

As to the main future function of the LEP, half of all respondents to our survey indicated that they saw attracting private capital from outside the authority as most important. This was followed by fostering cross authority collaboration (26%), bidding for government – either central or European – funds (20%), and lending private sector expertise to member authorities (4%). Clearly then, from the perspective of authorities, bringing in money will form a key role for the LEPs. Yet it also evident from the varied responses that there is, to some degree, a lack of clarity – as one respondent put it, currently 'the LEP has no function.' Below we offer some specific functions the LEP may help perform in the years ahead.

81 http://www.themj.co.uk/MemberPages/Subscribe/article.aspx?id=185761
82 Anonymised interview respondent.
83 http://www.re3.org.uk/

5.2 New Homes Bonus (NHB)

According to DCLG, the New Homes Bonus

- Addresses the disincentive within the local government finance system and makes it easier for areas to welcome growth;
- Provides local authorities with the means to mitigate the strain increased population [triggered by housing developments] causes a given area;
- Returns the economic benefits of growth to the authority and communities where it takes place, and thereby engenders a more positive attitude to development where new housing is more readily accepted.[84]

In part due to chronology – initiatives such as TIF and business rates reform awaiting implementation – the New Homes Bonus was the mechanism considered most likely to be used by the councils surveyed for this report. Over half indicated that they already used, or were planning to use, the NHB to fund future infrastructure requirements. A further 28% suggested that it may well play a role in helping finance such expenditure.

Over the six years of the scheme, almost £1bn will be allocated to match council tax receipts on new builds (and houses brought back into condition). An additional levy will be added for the building of affordable homes. There is an issue in two tier authorities where district councils may in some cases be net contributors to the business rates pool on the one hand, and yet stand to collect 80% of New Homes Bonus monies. This may incentivise a rush to build homes (and, given lower tier authorities are responsible for planning, they hold the power of approval) in areas which might better benefit from encouraging business growth.

Critics of the New Homes Bonus have pointed to its potential to exacerbate the north-south divide, and there is an issue about whether the south and south-east will benefit disproportionately from how the NHB is funded. It is, of course, not an entirely one way street. Based on year one estimates, Bradford will gain four times the amount under NHB that will go to Norwich, despite similar population sizes.[85] Similarly, Salford will recoup over five times the figure estimated to be in the pipeline for the London Borough of Havering.[86] Yet by topping up the £1bn figure with monies top-sliced from formula grant, the NHB is in part dependent on redistributing existing funding streams (and therefore moving monies between authorities), rather than just creating new ones. There is an issue of regional variance therefore – and of 'winners' and 'losers.'

An overarching concern voiced by interviewees regarding the NHB is that, whilst areas of high demand – such as the south east and, across the country, authorities near or in major cities – will receive a bonus from continuing to build relatively expensive housing for which there is demand (and affordable housing will be partially catered for by government subsidy), there is a middle ground of less expensive houses which will bring in lower council tax receipt (and therefore lower NHB), and which may see comparatively less stimulation from the mechanism.

On the one hand, local authorities can try and stimulate demand for such properties through initiatives such as the FirstBuy Scheme. FirstBuy, announced in the 2011 Budget, will see £400m of money provided by government in conjunction with developers to offer a 20% equity loan to top up first time buyers' deposit of 5% and thereby provide access to 75% mortgages. The equity loan is repaid when the property is sold and incurs no fee for the first five years.[87] Provided, clearly, such lending is not subprime – and appropriate measures of course need to be in place here – it is an almost cost free (in

84 http://www.communities.gov.uk/housing/housingsupply/newhomesbonus/

85 Norwich is set to gain £4m over the six years, compared to the £16.6m in Bradford.

86 £12.1m compared to£ 2.38m.

87 http://www.communities.gov.uk/housing/housingsupply/FirstBuy/

the long run) way of stimulating demand for the non-affordable, yet also non-luxury, housing market. As well as considering match funding the NHB to other government mechanisms therefore, there may be scope – given it is paid under section 31 of the 2003 Local Government Act, and is therefore un-ringfenced – for local authorities to invest such funds into a local FirstBuy scheme.[88] Over the six years, should all the monies be used for such a scheme, the NHB could fund 49 new FirstBuy schemes for homes in the lower quartile of Blackburn/ Darwen house prices, 53 in Harrogate, and 93 in Teignbridge.[89] Doubtless, many councils will use the NHB for multiple purposes, but its use (alongside other funds) for such a scheme would bring significant benefits. With 64% of authorities surveyed lobbying for more power over the NHB, this may be one such use it could be put to.

Survey Results

- 68% of authorities indicated that they would probably, will, or already are using the New Homes Bonus to help meet infrastructure requirements.
- Removing those authorities from London, the south east and west, and the east of England, this percentage remains the same.

Recommendations:

- **Authorities should continue to explore how they can use NHB receipts to match fund bids for monies (perhaps through cross authority pooling) to either central government or the European Union.**
- **Local authorities should consider how NHB monies can also be used to augment central government's FirstBuy scheme, and thereby further kick start the housing market.**

5.3 Community Infrastructure Levy

The Community Infrastructure Levy (CIL), as chapter two noted, is about providing a suitable trade off for communities to approve planning applications. With developers paying a tariff of, in some cases, over £100 per square metre of development, CIL is explicitly not about addressing existing infrastructure deficiencies but is intended to compensate residents for the challenges created by a new development. At present, and the matter is still under consultation, CIL cannot be used to provide affordable housing. That said, it does potentially offer a route to infrastructure developments in other regards. Six in ten authorities indicated that they had plans to use CIL to fund infrastructure in the coming years, with almost half (49%) having lobbied government for more power over the mechanism. It is predicted that the mechanism will provide between £6bn and £7bn worth of new funding over the next decade, 90% of which is to be spent on local infrastructure and 10% directed to more strategic projects.[90]

By passing down a 'meaningful proportion' of monies to town and parish councils, CIL has the potential to drive development from the bottom up. As

88 The Local Lend a Hand Scheme, run by Lloyds, is an important step in this direction: http://www.bbc.co.uk/news/business-12754818; http://www.lloydstsb.com/mortgages/llah.asp

89 Calculated via www.statistics.gov.uk

90 http://localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=7264%3Aproperty-industry-warns-ministers-against-widening-use-of-cil&catid=64%3Atransport-articles&q=&Itemid=32

noted in the Localis report *Power to the People*, planning has been characterised by feelings of public mistrust – both in the sense that communities often feel development is imposed upon them – and that they gain little from the process.[91] By devolving money to the lowest level, residents (particularly those who help draw up the new neighbourhood plans created by the Localism Act) will have a greater connection to the planning process, and therefore be more inclined to approve any given projects. Neighbourhood planners should also be encouraged, through their local authority, to speak to other groups in the area to see within CIL receipts can be pooled for schemes that benefit their neighbourhood, but also others.

If used astutely, CIL can almost function as an alternative tax increment financing scheme. Whilst TIF borrows against future earnings to make current development happen, CIL can help drive current development through the guarantee that future supporting infrastructure will be implemented. Whilst the above 'meaningful' proportion must be allocated to the neighbourhood where a given development is taking place, the rest can be used to support needs associated with the development across the authority. Whilst CIL has been criticised, like TIF, for only delivering in areas where there is pent-up demand for development (and there is legitimate concern here), it all depends on how CIL monies are deployed. The sums hypothesised in the January 2011 DCLG Consultation are not enough to deliver a step change in national infrastructure on their own, but if used to lever in private sector investment into the upfront development by using some of these monies (in concert with the other funding mechanisms) to provide infrastructure that benefits both communities and developer alike (building a road to a shopping centre, extending a tramline to a new housing estate, or beautifying a park near a school) the local authority can achieve a twofold gain. Several county councils interviewed for this project indicated a worry that such monies (when devolved to the lower tier) will not be used in an overarching strategic fashion, but there may be a way around this impasse. Neighbouring lower-tier authorities can pool CIL receipts – potentially most profitably through their LEP – and thereby help deliver a joined up infrastructure system from the bottom up.

Recommendations:

- **Long term, LEPs should scope out the potential for a formal cross-authority 'receipt pooling' function for CIL, and liaise with DCLG on the feasibility of creating this.**
- **Community groups/parish councils should be encouraged to draw up a list of infrastructure requirements across the authority and investigate whether they can club together with neighbouring groups for economies of scale.**

5.4 City Deals

In December 2011 the government published the outline for a series of 'city deals.' Eschewing 'blanket policy presumptions,' 'an illustrative menu of bold options' has been offered to the eight core cities – Birmingham, Bristol, Leeds, Liverpool, Manchester, Newcastle, Nottingham, and Sheffield. With the GDP of these cities lagging significantly behind their largest non-capital city

91 C. Balch, *Power to the People: The Future of Planning in a Localist Landscape*, Localis, 2011

counterparts in France, Germany, Italy and Spain, a range of measures has been offered. These include access to a £100m capital pot for competitive bids for broadband infrastructure plans, devolution of local transport funding, and greater planning freedoms.

In return cities will need 'demonstrate strong, accountable leadership, clear goals, and [an ability] to boost private sector growth.'[92] With the impending referenda over city mayors in 10 of the largest English cities set to take place this year, the government has made the case for 'stronger, more proactive and individualised style of leadership' delivered by 'directly elected mayors.' The co-ordinating powers of the Mayor of London are evidenced in the next chapter, and certainly the relative ease with which the Crossrail bond was secured owes much to the overarching powers of just such a figurehead. Mayors may also seek to help co-ordinate a business rate supplement (BRS, as with Crossrail) or even a BID – explored in chapter seven – to raise revenues for major projects.

In the 2011 Autumn Statement the Chancellor indicated that the government would also consider allowing city mayors to borrow against future CIL receipts 'where this can make a significant contribution to national infrastructure.' This, used in junction with TIF, was held up as one of the potential benefits – beyond the 'informal powers which enable them to influence, persuade and co-ordinate on a wider scale' – for the core cities to adopt elected mayors.

In January 2012 it was announced that the city deals concept would be extended across the country, and that others would be invited to agree 'a bespoke deal with Government to unlock their potential.'[93] For varying reasons – to maximise an already successful local economy, or attempt to drive inward investment – cities outside the 'core' eight should consider what use they can make of the new deals on offer.

Recommendations:

- **Those cities seeking to use CIL as a form of Tax Increment Financing should approach the government to see what terms may be on offer for any 'city deal'.**
- **In cities that vote for mayors, those mayors should seek to maximise their powers as to borrowing against CIL, and co-ordinating BID/BRS schemes.**

92 http://www.dpm.cabinetoffice.gov.uk/sites/default/files_dpm/resources/CO_Unlocking%20GrowthCities_acc.pdf

93 http://www.communities.gov.uk/news/newsroom/2072389

6. New Borrowing Options

Chapter Summary:

- Given the increased cost of borrowing from the PWLB (gilts + 100 basis points), it is likely bonds will play an increasingly important role in the local government landscape.
- Whilst some authorities have gained an individual credit rating, schemes surrounding a collective bond issuance should be explored further.
- Derivatives form an interesting way of mitigating against the risks within the financial markets.
- Tax Increment Finance schemes one (small scale) and two (larger scale) both have a role to play in financing future infrastructure.
- Local authorities should seek to auction a TIF and/or Enterprise Zone (and thereby outsource the risk) to the private sector.

Numerous participants interviewed for this project indicated that the October 2010 PWLB rate rise has triggered a willingness to explore alternative borrowing options. Given the limitations on monies local authorities can raise through taxation – direct taxes such as NNDR being centrally pooled, indirect mechanisms such as CIL/NHB subject to regional variation – borrowing will form a key part of any growth strategy.

As Tony Travers, Director of LSE London, has recently noted, 'lenders looking for a secure home for their money will find few better homes than British local government.'[94] It may be time to use this privileged position to increase their borrowing in several ways. Councils are understandably cautious, but making prudent choices they can deliver much needed growth in the short term, and infrastructure over the long run.

There are clear structural problems with an over-reliance on any one mechanism. The new growth incentives will have some impact but £1bn of NHB over six years, and £6-7bn of CIL over a decade, are unlikely to deliver a step-change on their own. Rather, local government needs to engage with private capital, and seek out the terms on offer. Bonds, derivatives and TIF will all play a role here.

94 Ibid.

6.1 Bonds

There is significant global precedent for local government accessing the bond market. Major infrastructure projects have been financed by municipal bonds in Romania, Russia and Slovakia in recent years, and German regional governments issued 770 bonds between 2000 and 2007 – 82% of the European total for that period.[95] Pan-local government bond schemes exist in the low countries, Scandinavia, and France. Similarly, the United States has issued municipal bonds since 1812, and Portland's Rose Garden Arena is one of many high profile bond funded constructions to have emerged in modern times.

Whilst American States are of a sufficient size to reduce the risk of default (and thereby secure bonds at an attractive rate), the same is not true of individual Swedish (or indeed the majority of British) local authorities. Founded in 1986, Sweden's *Kommuninvest* scheme aims to help municipal governments club together and collectively raise capital through the European and Japanese bond markets. By spreading the risk *Kommuninvest* has achieved a triple A rating from both Standard and Poor's and Moody's, and thereby attracted investors from across the world. Almost one-third of investment comes from Japan, with a further 20% from the United States.[96] Sweden, like the United Kingdom, benefits in this respect (i.e. access to cheaper rates) from being a member of the European Union, whilst avoiding the dangers of its currency. Its brochure for potential investors places this fact centre stage – and, with recent defaults in Eurozone countries, not without reason. For credit worthiness in the bond market, financial autonomy reaps rewards – something of note to English government both central and local. As a measure of its success, 267 of the 310 Swedish local authorities have joined the scheme, with lending rising by 8% even in the tough financial climate of 2010.

The Swedish experience has been different from the English in three crucial regards. Firstly, as mentioned, until 2003 central government had to approve every attempt by local government to go to the bond market for funds. Such need for credit approval produced a situation where, between Leicester and Salford seeking finance for housing and infrastructure in 1994 and the GLA seeking funding for Crossrail in 2011, no English local authority issued a bond.

The size of the authority itself is also of paramount importance. *Kommuninvest* works precisely because local municipalities can combine into a larger unit that can therefore offer the required security to gain the prized triple A rating. Birmingham or Surrey, for example might be able to issue an attractive bond on their own, but the same it is not true for all English authorities.

Size aside, Swedish municipalities have a level of autonomy far in excess of their British equivalents. They have unlimited power to set local income taxes, are constitutionally unable to declare insolvency or suspend payments, and the chance of them defaulting is therefore close to zero. Any investor in Swedish bonds knows their investment will return. The same could not be said of a financially more neutered British authority. London however forms an important exception.

95 Daniel Platz, *Infrastructure Finance in Developing Countries – the potential of sub-sovereign bonds* (UN Department of Economic and Social Affairs Working Paper, 2009) http://www.un.org/esa/desa/papers/2009/wp76_2009.pdf

96 Kommuninvest, investor presentation accessed via http://www.kommuninvest.org/en-gb/investor-relations/financial-information-and-publications/kommuninvest-in-one-minute.php

The Greater London Authority and the Crossrail Bond

The £600m bond to help part fund the GLA's £3.5bn share of the Crossrail project is an important step forward for infrastructure finance. The bond works out at around 0.17% cheaper than the October 2010 PWLB rate and, since the GLA has committed to achieving at least equivalent savings on future borrowings, a total of £65 million could be shaved off the cost of long-term borrowing for Crossrail. This could have the welcome prospect of shortening the term of the Business Rate Supplement – scheduled to run until 2035 – and thereby reduce grumbling amongst businesses which are currently paying (if they have a rateable levy of over £55,000) a 2p levy.[97]

London is, admittedly, a special case. Its ability to raise additional funds through levying a tax (such as the Business Rate Supplement) on a large, relatively affluent group of businesses not only provides the funds for large scale infrastructure, but gives the bond market confidence that the GLA will be able to repay any money borrowed. Not every local authority will be able to muster such confidence (or necessarily, even with the new LEPs, the financial expertise) however. In this light the *kommuninvest* model, as mentioned, offers food for thought as to how smaller authorities can think big.

The Local Government Association recently modelled the impact of a *kommuninvest* type scheme in England. Proposing that local authorities could borrow up to £7bn – saving up to £500m in costs over 25 years – the LGA argued in favour of a collective borrowing vehicle spanning tens, potentially hundreds, of authorities.[98] The scheme, they argued, would be able to achieve a rate of 70-80 basis points over gilts, 45-55 points over the new HRA PWLB rate, but 20-30 points below its standard rate. 35% of authorities we surveyed could envisage a significant amount of authorities using the rate for purposes other than housing.

Survey Results

Though some of the authorities we spoke to expressed doubts regarding the feasibility of a pan-LGA scheme, it is important to note that just under two in three authorities we surveyed expressed an interest in joining with other authorities in issuing a collective bond. Given 83% of authorities described their previous experience of cross authority collaboration as in some way positive, there may be space – using the mediating role of the LGA and/or various LEPs – to apply such positivity towards future bond issuance. The fact that the type of infrastructure projects local authorities are looking at – transport (75%), communications (71%), waste (41%), and energy (28%) – are often those which benefit from cross authority input and economies of scale is also worthy of note. Bonds, long term and large in scale, can play an important role in such projects.

97 Crossrail business rate supplement,' http://www.london.gov.uk/crossrail-brs

98 See *LGC*, 17 March 2011.

Several larger authorities (and some smaller ones) have already gained a credit rating with one of the key agencies. For example, Standard and Poor's, Moody's and Fitch have authorities listed at the following ratings:

Authority	S and P's	Moody's	Fitch
Birmingham	AA+	-	-
GLA	AA+	-	-
Woking	AA-	-	-
Cornwall	-	Aaa	-
Lancashire	-	Aa1	-
Guildford	-	Aaa	-
Wandsworth	-	-	AAA

Despite the laudable ambition of these authorities, there are challenges any council going into a bond issue single handed will face. The first, as mentioned, surrounds the rate they can obtain. In the six cases above, sound credit ratings should achieve a reasonable rate not excessively (compared to other potential funding options) above gilts, yet this will not be the case for all. The second concerns the cost of achieving a credit rating which is likely to be above £20k and could be as high as £50k. For a major city council this is relatively small fry, but for the average district authority – which are undertaking major initiatives such as shared chief executives in order to save sums not massively dissimilar to this upper estimate – this is no small figure.

According to our survey, interest in the bond market has increased over two and a half times as a result of the initial October 2010 PWLB rate rise (11% to 29%). Through LEPs and, it appears, the LGA, this growing interest may be converted in a more pro-active stance than hitherto. There is an issue of cross indemnifying – i.e. bearing the risk of a partner authority defaulting – but there are clearly rewards (a cheaper rate than 100 basis points over gilts) to be had here, as indicated below.

The Northern Hub Railway Network

Crossrail, as mentioned, serves as an example of a large scale project where the transactional costs of issuing a bond were offset by the desire to deliver a major infrastructure development. The umbrella nature of the GLA makes co-ordination for such a scheme easier than others may well find, yet it is important to note that there are alternative cross-authority projects (and other than those included in the 2010 and 2011 Infrastructure Plans) that could bring significant benefits. One example of this is the much mooted Northern Hub railway network (improvements to existing, underperforming, railways), linking Liverpool, Manchester, Leeds and Newcastle and providing 700 additional services a day. Here it is estimated £560m worth of investment could provide eight times this sum in benefits, but the problem remains finding this initial investment.[99] Covering around 50 local authorities, this scheme would require a significant degree of co-ordination were it to be driven from the bottom-up (and bonds would potentially be but one part of the risk), but the rewards are there. Central government, the LEPs, and Network Rail would need to be brought into any discussions to get this scheme off the ground, but given the government's commitment to revitalising the 'core cities' outside London this project would form a positive step towards investing in the north.[100]

99 http://www.insidermedia.com/insider/north-west/59269-network-rail-submit-560m-northern-hub-plans/index.html

100 http://www.bbc.co.uk/news/uk-england-15062142

Whilst then a collective (and permanent) finance agency may be difficult to co-ordinate for the hundreds of authorities who are members of the LGA at present (and that is not to say that efforts in that regard should not be made), projects such as the Northern Hub would benefit from some form of one-off arrangement. The cost of a single credit rating would be more than offset by the savings made in the borrowing itself through the advantageous credit rating on offer. Pulling some fifty authorities together is, in itself, no easy feat, but the matter – and central government and Network Rail's potential reaction - is worth further exploration. A pooled issuance would involve the setting up of some form of independent vehicle, a guarantee from each authority as to the vehicle's long-term financial viability, and would have the financial strength of the smallest authority as well as the largest taken into account when setting its credit rating. Certainly however, the combination of several large cities (in many cases potentially under the authority of a single mayor from November 2012) within any collective Northern Hub bond would help offset this latter point. Should such one-off arrangements be undertaken successfully, a more permanent local government finance agency may lie further down the road.

Recommendations:

- **Bonds – given their often 25-30 year lifetime – will form key a part of any future funding solution. Both the LEPs and the LGA will be important in offering advice here.**
- **Whilst a pan-LGA scheme may prove difficult at present, a limited cross-authority issue for a single purpose such as the Northern Hub should be scoped out by all interested parties (central government, local authorities, and, in this case, Network Rail), and may prove a stepping stone for a more permanent institution in later years.**

6.2 Derivatives

At present, it is unclear whether the use of derivatives by councils will still be considered *ultra vires* when the General Power of Competence takes effect. Derivatives – be they futures, options or swaps (which proved problematic for local authorities in the late 1980s) – allow investors to hedge the risk of an initial investment by acquiring an interest in a related financial product. Several councils, including Lancashire, have argued that using a 'gilt lock' – which fixes the price of the reference gilt prior to issuing a bond – would allow them to mitigate against any 1980s style risks. The government has intimated that discussions on the issue have 'not produced convincing arguments one way or another.'[101]

The example of Italian local government is often held up as warning on derivatives. Between 2001 and 2008 525 Italian authorities entered into almost 1,000 interest rate swaps with an aggregate value of €35bn. The pricing of these swaps however was modelled in such a way that authorities would lose money in almost any economic circumstance, and would have to pay significant amounts to unwind the transaction. Banks even retained the ability to restructure swaps to extend their maturity – i.e. lower individual outgoing payments but increase the amount to be paid back in the long run. The Bank of Italy estimates losses to be about €1bn on the basis of the swaps, and senior Italian bankers

101 *LGC*, 18 August 2011.

have estimated that losses could reach ten times this amount – approaching a third of the initial outlay.[102] Several lawsuits have been launched alleging that such derivatives were mis-sold, and there may be a role for LEPs to advise – this report contends – on such matters in England.

The issue is not yet live in the UK, but it is about to become so. Since 2008 Transport for London has had the power 'to make arrangements for risk mitigation in respect of prudent management of [its] assets,' and can therefore invest in derivatives.[103] In March 2011 the TfL Board approved their use as part of the group's investment strategy for 2011/12.[104] English authorities, as mentioned, are pressing for powers in this regard, and for the purposes of reducing risk there does seem to be real merit here. Should authorities be obliged to use monies raised in any bond borrowing for immediate use, rather than long term hedging, this would also help limit any potential 'addiction' to the capital markets. The TfL Act could therefore be used as the basis for similar legislation covering all local authorities.

Overall, some balance is needed. Derivatives' major role in the financial crisis was in large part created by the widespread failure of the credit rating agencies and, in any case, there was comparatively little connection to over-the-counter initiatives such as credit swaps.[105] As with PFI however, local authorities will need to be financially savvy, and have a range of trusted contacts outside their authority – in central government, the private sector and, perhaps most immediately, their LEP – to advise them on this. It may well be advantageous for those LEPs without a representative from the financial services industry to, after due consideration, invite such a figure onto their board to act as a 'go-to' for member councils. At present, BIS guidance refers to boards having 'firsthand knowledge and experience of the local business environment,' possessing a 'breadth of experience from small enterprises through to large businesses, and representing key sectors,' and offering board seats 'to other key economic stakeholders such as universities or social enterprises.'[106] Given the likelihood of authorities using new and complex financial mechanisms in the coming years, the government should seek to offer greater guidance here, as indicated below.

Recommendations:

- **Derivatives should be used to offset the risk of authorities entering the bond market. The government should indicate it views the use of derivatives positively, and legislate for their use for the purposes of risk mitigation.**
- **Where LEPs do not contain a representative with experience of the financial services sector (principally banking), they should be encouraged by central government – whilst ensuring this individual has a meaningful commitment to the local area – to appoint such a figure to their board to offer advice to member authorities seeking to evaluate the new financial mechanisms.**

6.3 Tax Increment Financing (TIF)

The government's plans for greater local retention of business rates is set to largely remove the most signifcant barrier to the implementation of TIF: the

102 *Financial Times*, 9 March 2010.

103 http://www.tfl.gov.uk/assets/downloads/corporate/Item06-Board-30-03-2011-Treasury-Management-Strategy.pdf

104 http://www.tfl.gov.uk/assets/downloads/corporate/Item06-Board-30-03-2011-Treasury-Management-Strategy.pdf

105 http://www.cityoflondon.gov.uk/NR/rdonlyres/63A7F266-B2F5-4AEE-93E6-09527486390F/0/BC_RS_OTCDerivativesReport.pdf

106 http://www.bis.gov.uk/policies/economic-development/leps/board-membership

uncertainty over future NNDR streams. It is therefore worth outlining the two paths it may take in the coming months. The recent DCLG consultation laid out two options which, broadly speaking, take the following form:

- The first would allow local authorities to determine for themselves whether to invest in a TIF scheme, but would not exempt revenues from the impact of the retention scheme – i.e. they would still be taken into account when distributing the top-up and tariff of NNDR.
- The second would involve stronger government controls on the ability to bring forward a scheme but would guarantee revenues, without the risk of loss to the levy and reset process, for at least ten years. As central government would seek to maintain a high degree of NNDR equalisation across the board, this would inevitably result in fewer TIF schemes.

In December 2011 the government announced it would allow the use of both options. Option one, it argued, would allow small scale projects which could be repaid within the reset period to go ahead. Option two will facilitate larger scale projects being funded on a limited basis. Although we believe that allowing both options is a positive step, it is option two that may have the most impact – generating developments of such a size that they will have knock on effects for local economies.

Though we largely welcome the recent move therefore, there is an issue surrounding both TIFs and EZs. A number of interviewees suggested that they believed some LEPs had selected their Enterprise Zones for the purposes of regenerating a particular area, rather than focusing on creating genuinely additional NNDR as the government intended. The fear also remains that TIF option two could be allocated in a similar way.

The Nine Elms area spanning parts of Lambeth and Wandsworth Borough Councils will see significant regeneration under a TIF scheme – including the extension of the Northern Line and the building of 16,000 new homes. Image courtesy of CGMA and Foster + Partners.

One way around this would be for each LEP to be given one additional TIF and one additional EZ they could auction to the private sector (who would then receive all or, most likely, a significant percentage of the future NNDR generated). Capturing the spirit of the Local Asset Backed Vehicle we will turn to in the next chapter, this would generate up-front monies for further capital investment (thus potentially create the capability for another TIF option two), provide (if a percentage of rates were retained within the local authority) an additional localised stream over (depending on the mechanism) a 10-25 year period, and ensure that there was genuine private sector demand for said development since most of the risk would be outsourced to them.

As for additionality, two safeguards could be put in place. Firstly, the LEP could take and redistribute a percentage of both the up-front payment and ongoing tax receipt the local authority awarded the private sector EZ/TIF would receive. This would incentivise the different authorities within the LEP to pick the most productive area for either scheme. Secondly, when assessing the various bids for private sector involvement, by placing a high importance on criterion such as additional jobs created and additional capital investment in the decision making process, these could then be used to hold said private sector partner to account. Should they not emerge, the percentage of NNDR the private sector would receive could be reduced or, alternatively, if targets were exceeded, augmented. A solid and robust procurement process would clearly be important here.

The Treasury, it appears, is currently considering the merits of a nationwide scheme – whereby developers would approach them with an offer and they would have the final say. Local government should take a lead here, and argue for a bottom-up, locally led version of this mechanism – determined by LEPs and local authorities, not Whitehall.

Recommendations:

- **TIF will work best where borrowers can evidence a certainty of future income. To achieve this, the mechanism's exemption from the levy and reset process of any business rates reform as per consultation option 2 is a sound decision for large scale infrastructure. Option 1 will however also play an important role in smaller scale developments.**
- **LEPs should seek to "auction" an additional Enterprise Zone and TIF scheme to the private sector, and central government should explore permitting such arrangements.**

7. Towards a New Public Private Settlement

Chapter Summary:

- PFI continues to be used by authorities, though its importance is being scaled back.
- Local Asset Backed Vehicles offer, provided the procurement process is rigorous, a potentially more attractive option.
- The Business Improvement District model is worth significantly extending.
- UK private pension funds offer a huge (c.£2tn) pot of potential funds for infrastructure, and should be encouraged to invest further in such undertakings.
- The Local Government Pension Schemes should play a role in helping facilitate this.
- A National Infrastructure Bank, capitalised in part by both public and private pension funds, could play an important role in driving future growth.

Despite widespread distrust (72% of survey respondents) in PFI proving a value for money mechanism for local government, our survey shows that most authorities both expect and welcome greater private sector involvement in local economies in the coming years. More than one in four authorities plan to consult the private sector on the pros and cons of the various financial mechanisms, and one in three will look to their LEP – both figures higher (albeit marginally) than the amount planning to look to central government for advice. Similarly, over three quarters of authorities welcome greater private sector involvement in economic development.

Put simply, the nation needs growth, needs it quickly, and local government knows it. Quite apart from both public and private sectors seeking to identify shovel ready infrastructure projects – the quicker infrastructure is being built, after all, the quicker it provides jobs and tax receipt – the following mechanisms we believe will form part of any new public-private partnership in the years ahead.

7.1 Local Enterprise Partnerships (LEPs) and the Growing Places Fund

As part of an ongoing drive to ensure infrastructure does not founder amidst a situation of relatively illiquid market for private sector capital, the government has recently launched the Growing Places Fund. Distributed on a formula basis, the fund aims to generate economic activity by providing an investment stimulus to infrastructure development that is currently stalling.[107]

107 50% through population size, 50% through Employed Earnings – total number of employees multiplied by mean gross weekly wage.

The fund, providing £500m to LEPs and allowing them to prioritise the infrastructure they desire, is intended to be a revolving mechanism which will allow funds to be reinvested and thereby unlock further development. In helping fund the initial development stage, the intention is to stimulate the private sector and then, in future years, developers paying back the public sector outlay through their financial receipts or land value uplift.

LEPs, then, have a key role in helping unclog stalled projects. In response to our survey, four councils in ten saw bringing forward already scheduled capital expenditure as the most important element in driving economic recovery. Given the cross-party consensus at a national level that this should be so (albeit, as mentioned, with parties differing on the details), there may be room for authorities of different colours to press on this issue – particularly given the pan-authority nature of the LEPs.

7.2 European funds

The Growing Places Fund is similar (in that it is intended to be revolving) to the use that has been of various European Union monies. As the Greater Manchester Waste Development Agency deal in 2009 illustrated, local authorities have previously made use of combining EU monies with their own capital and other funds from the private sector. Since 2000 England has received around €5bn of funding, with a further €3.2 billion being invested between 2007 and 2013 in local projects around the country. A recent manifestation of this are the various JESSICA – Joint European Support for Sustainable Investment in City Areas – schemes underway, of which Evergreen in the north west has led the way.

Evergreen North West Fund[108]

Investors in the Evergreen fund, which made its first investments for commercial property developments in areas of the North West outside Merseyside, was initially funded by:

- European Regional Development Fund, £30m
- Greater Manchester Property Venture Fund, £50m invested as equity rather than debt
- Lancashire Pension Fund, £50m
- An as yet undisclosed bank is close to agreeing a lending facility of between £200m and £300m available on a case-by-case basis
- North West Development Agency, £28m in the form of land and £22m funding from UK Single Programme regeneration budget

Developers are required to put in cash or debt to make up project costs. The rules of the fund mean it must make a return rather than simply give money in the form of grants as in previous European regimes. Claw-back will begin ten years after the launch.

The initial plan from the European Investment Bank, guarantor for the funds, was that the JESSICA fund would offer development guarantees (and take equity) for projects. State aid competition rules, however, meant that senior (i.e. that which is paid out first when repayment is due) and mezzanine debt would be the initial form of finance.

108 http://www.placenorthwest.co.uk/news/archive/7229-evergreen-fund-on-course-for-500m-launch.html

Such emerging public sector co-investment fund structures will prove important in the coming years. JESSICA allows revolving investments in regeneration projects that create employment and investment opportunities, and thereby make an area more attractive to investors which in turn stimulate more such opportunities. As Evergreen illustrates, by securing investment from the EU, authorities can lever in venture capital and pension funds, and thereby stimulate growth in the coming years. Precisely half of our survey respondents indicated that they plan to use European Regional Development and/or Social Funds in the coming years – the key will be to use these mechanisms to lever in even more money, where the right deals can be structured, from the private sector.

7.3 Private Finance Initiative (PFI)

The August 2011 Select Committee on the Private Finance Initiative highlighted some headline data – if all PFI liabilities were included in the National Accounts, it is estimated, the national debt would increase by £35bn. The average weighted cost of PFI, the committee also noted, was double that of government gilts (8% compared to 4%) – thus necessitating some significant savings in costs and efficiencies during the lifetime of a PFI project if these schemes are to break even (a pattern present projects would indicate is often unlikely). These are serious charges, and evidence seems to indicate systemic flaws at every stage of the PFI process – an inbuilt bias to assume non-PFI projects will overrun in the procurement process, an insufficient transfer of risk during construction, and a failure to review/renegotiate contracts once it has been established they represent poor value for money. When asked to comment about what would most improve the mechanism, a significant proportion of authorities responding to our survey answered 'scrap it,' or some variant thereof.

That said, despite anti-PFI rhetoric prior to the election from both coalition partners, the mechanism is far from dead. At present, the Treasury likely to give the go-ahead to 61 PFI deals currently in the pipeline – from schools to roads – and thus money will still continue to flow through such channels. Whilst the local authorities surveyed for this report indicate real doubts that PFI will provide value for money in the coming years, this mechanism seems likely to continue as part of the Treasury's armoury. Days after the Treasury Select Committee's verdict was published, Sheffield City Council agreed a £2bn contract for a firm to take control of maintaining the city's streets and highways leading the Deputy Prime Minister – whose parliamentary constituency is encompassed by the terms of the deal – to comment that 'a lot of lessons have learned [on PFI]. [Whilst] some of the early ones have proved to be very poor value for money' the Sheffield deal represents 'much needed investment.'[109]

There is a difficult balancing act to be reached therefore. Infrastructure investment is much needed, and public private partnerships (which can leverage a multitude of skill sets and powers) provide a means of achieving this. Similarly, as ever, it will be up to the public sector to negotiate the best use of taxpayers' money, but in the initial stages this will be against private sector companies who possess greater skill sets in this regard, and will often, as previous experience has shown, extract a good deal for themselves. A tough negotiation stance, and the advice of LEPs, will be of importance for local authorities here.

7.4 Local Asset Backed Vehicle (LABVs)

Whilst drawing attention to some of the problems of PFI, the Treasury Select Committee was more sympathetic to exploring options around Local Asset Backed Vehicles. In a LABV, a local authority contributes land and a private firm the skill sets and finance to develop that asset. The key is to reach a series of agreed

109 http://www.yorkshirepost.co.uk/news/at-a-glance/main-section/clegg_backs_pfi_deal_in_own_city_but_denies_any_u_turn_1_3722954

outcomes for the joint venture from the outset, and ones which ensure profit for both private and public partners. LABVs to date have avoided the lengthy procurement period and upfront costs of PFI, they strengthen local authorities' business acumen (which will help arm them in future negotiations), and, whilst maintaining a significant (normally 50%) risk within the local authority, have the potential to deliver both infrastructure, and a profit.[110] LABVs are, it must be noted, heavily dependent on location – in determining the amount of private sector demand there is to enter into a joint venture (and thus the terms an authority can extract), and local demand for varying types of infrastructure. If councils wish to truly place shape, however, combining a LABV with some of the other forms of investment delineated here can lead to significant regeneration.

Sheffield Housing Company

In March 2011 a deal was signed between Sheffield City Council and a developer to build around 2,300 homes in 'areas where regeneration is needed the most' across the city. With the local authority putting in the land, and the developer investing capital equivalent to this land's value, it is a 50:50 partnership between both parties. Arguing that much of the brownfield land used for the development is unattractive in piecemeal form, and that there was a lack of demand even when the housing market was more buoyant, the council hopes by retaining a 50% share in the project it can capitalise in later years on any housing market recovery. The Sheffield Housing Company will target local labour for the construction stage, and create training and employment opportunities in the coming years. 35% of properties built will constitute affordable housing. It is expected to create £330m worth of investment.[111]

LABVs are not an ideal fit for every authority – yet for those areas that can identify a suitable pipeline of public works, they provide an opportunity for a local authority to divest itself of land that can be put to good use in a public-private partnership. Basingstoke and Deane Borough Council have recently announced a £200m scheme with a developer to regenerate Basing View. By committing £3.3m to infrastructure improvements on the estate, and earmarking a further £5m of investment to stimulate new development, the council intends to drive over 700,000 square feet worth of development. As the freeholder of Basing View, the council has an important decision to make regarding the best use of its land and, in this case, has plumped for regenerating it through public-private means.[112] Local authorities may of course also wish to combine their land with other public sector bodies in order to achieve a more attractive plot.

The key here will be to get procurement processes as efficient as possible. LABVs will require dedicated resource (the land used, but also council member and officer time) for a substantial period, will require a defined pipeline of works (which will evolve as time passes), and are of course dependent on finding the correct partner. Local authorities will also have to consider that public and private interest will not always align, and that land that the private sector wishes to develop will not always be what is best for the community. They will need to take a congenial but firm line here. Beyond land currently under public ownership, the new land auctions may provide a mechanism to put private land to better use, and, councils should explore how such land could be effectively rezoned. In essence, they allow authorities to move beyond the sometimes siloed approach to capital projects in house (through the strict demarcation lines inherent in the

110 Treasury Select Committee, Section 4.

111 www.sheffield.gov.uk/shc

112 http://www.destinationbasingstoke.co.uk/?page=BasingViewRegeneration

political structure of an authority) and, together with a private sector partner, manage a series of regeneration projects under one umbrella organisation. 38% of respondents to our survey indicated that the current availability of local developable land would help allay their future infrastructure need, 10% more than those seeing it as a hindrance. In times of fiscal austerity, it is time for local authorities to make increasing use of this important resource – and, as with their finances, this may sometimes mean combining plots of land with other authorities where this offers advantages to all concerned.

Recommendations:

- **Local authorities should take a positive line on Local Asset Backed Vehicles (LABVs) in general whilst seeking to be robust in their procurement practises for such schemes.**
- **Where authorities have empty land on or near their boundaries they should consult neighbouring authorities about launching a joint LABV.**

7.5 Business Improvement Districts (BIDs)

For small scale infrastructure, Business Improvement Districts (BIDs) have shown how retaining money locally can lead to development. Created by the 2003 Local Government Act (they have been used in the United States and Canada since the 1960s), BIDs are established via a referendum in which local business ratepayers agree to fund a range of services and/or infrastructure in their area for a period of five years (at which point another referendum may be held to renew or alter the scheme). A majority of both ratepayers and ratepaying value must vote yes in the referendum – thus protecting the interests of both small and large business. 124 BIDs (from 187 ballots) have been established to date, and individual BIDs have levied £440k in both Solihull and Swansea. Theoretically, a BID could cross or even span the entirety of different authorities, and thereby localise the business rate levy within that area. At present, a cross authority scheme requires the say-so of the Secretary of State, and there may be room for local authorities to proactively press DCLG more on this issue than hitherto. Reversing the emphasis within Section 42 of the 2003 Local Government Act to enable the Minister to prevent a given scheme, rather than their explicit approval always being required, would be a positive step forward.

Beeston BID

Beeston near Nottingham is an example of an ongoing BID. Following a successful referendum in October 2010, the five year BID came into being in January 2011. Each business within the BID with a rateable value of more than £25,000 will pay a 2.5% levy whilst those over £25,000 will pay 2%. Though the pre-referendum business plan made clear to voters that BIDs were 'not a way for local authorities to get more money' it does promise to leverage in a sufficient amount of capital, directly and indirectly, that may help fund small scale infrastructure in the near future.[113] In the years up to 2015, £1m will be invested into the BID – topped up by a £89k loan from the council. Initial projects include touch-screen maps for the town centre and office refurbishment. Small scale perhaps, but indicative of how business can voluntarily contribute to the infrastructure of an area.

113 http://www.beestonbid.org/pdf/BBID_Plan_August_2010.pdf

Whilst the Beeston BID indicates currently evolving practice, Newcastle has shown the type of physical infrastructure a BID has helped deliver:

Newcastle BID

Following a ballot in November 2008 where 67% of all ratepayers (59% of rates) approved the introduction of a BID, the scheme levied almost £1.5m in its first year. The area covered by the BID encompasses the NE1 postcode of Newcastle city centre, and aims to 'secure [Newcastle's] place its place in the "Premier League" of European Cities.[114]

Its scale, and healthy business rate base, has allowed the BID to make significant strides. In July 2011 a 'Paris-style' bicycle rental scheme was launched – whereby users pay a 1p registration charge and have access to a pay as you ride fleet of bikes. Likewise, in August 2011 12 new pontoons were added to the banks of the River Tyne (to form the Newcastle City Marina) through funding delivered by the BID together with additional finances from the city council.[115]

Councils should therefore canvass local businesses to see the demand for improvements in individual localities, and, where possible and if necessary, where they can offer to match fund a BID prior to referenda. Yet ambitions need not be limited to street-by-street, or even postcode wide, schemes. By scoping wider, even cross-authority BID schemes, councils may find there are ways to leverage private sector involvement in areas that have not yet been tapped sufficiently.

Survey Results

Only one in five respondents to our survey had pressed the government for more power in regard to BIDs, with a small majority (52%) noting that they did not plan to use the mechanism in the years ahead. Such thinking is in need of some evolution – BIDs offer a vehicle of matching private-public interest with little cost, crucially in current times, to the latter. The LEPs, with their pan-authority scope, may have a significant role in both smoothing the ground, and scoping out cross-authority projects.

In the seven years after the first successful BID ballot in November 2004, 88 BIDs achieved an over 70% yes vote from their total rateable value, and 85 saw over 70% yes votes from the total number of businesses. This suggests that there may be room to push the standard BID levy upwards, even in distressed times. Whilst rates have varied (for example, Preston 1%, Worcester 1.5% and Mansfield 2%), BID campaigners may seek to be bolder in the schemes they bring forward. A 3% levy on NNDR nationally would bring in over £0.5bn – whilst a national BID would be infeasible, cross authority schemes (as mentioned) should be explored further.

114 http://www.newcastlene1ltd.com/about-ne1/the-bid.aspx

Recommendations:

- **LEPs should take the pulse of local business communities and local authorities should offer match funding for a BID where it can help deliver infrastructure development.**
- **With the potential for cross-authority schemes, a greater BID levy of 3% should be considered to help fund more ambitious projects.**
- **Central government should legislate to reverse the emphasis of Section 42 of the 2003 Local Government Act giving the Secretary of State the power to prevent cross-authority Business Improvement Districts, rather than force local authorities to seek their say so for any such scheme.**

7.6 Taxation options

Though there are limits as to what authorities may do with the c.£22bn they raise in council tax per year (and the Localism Act will necessitate any rise above 3.5% to be subject to referenda), using other forms of taxation to fund infrastructure remains an option. Several councils we spoke to mentioned the viability of a local bed tax, and a £1 charge per overnight stay (the figure mentioned by a couple of interview respondents from major cities) would have provided an extra £1m to Bath, £1.4m to Leeds, and £3.6m to Birmingham in recent years.[116] Others, as in the example below, are experimenting with new forms of de-facto taxation:

Nottingham City Council's Work Place Parking Levy

Another option is to implement a Work Place Parking Levy, and Nottingham City Council is implementing such a scheme from April 2012. In order to reduce an estimated £160m loss in economic productivity caused by traffic congestion (70% of which, during peak hours, is down to commuters), the council is implementing a levy on all businesses which provide 11 car parking spaces or more (blue badge holders are exempt). It is estimated that this will raise £14m per year over a 23 year period, and these monies are proposed to be used to match fund improvements to the tram system – including two new tram lines and a station refurbishment.[117]

In the current climate, and given recent governmental discussions on the issue, there may also be some mileage in pursuing options around a mansion tax. In their 2010 election manifesto the Lib Dems pledged that they would introduce a 1% tax on property values over £2m: it would, they calculated, raise £1.7bn. More recently, Consultation Paper 103 circulated at the 2011 Liberal Democrat party conference asked members whether they would be in favour of introducing such a mechanism with allocation of its receipt based on varying local authority need. Revenues raised under the Lib Dem proposal would constitute a figure worth over half the proposed capitalisation of the Green Investment Bank (£3bn), an entirely new Regional Growth Fund (given the initial investment pledge was £1.4bn), and, most interestingly, a large amount of the up-front capital required a new National Infrastructure Bank, outlined below. Discussions about wealth tax

115 http://www.newcastlene1ltd.com/our-programmes.aspx

116 http://www.civitas.eu/index.php?id=66&sel_menu=35&city_id=103; http://www.idea.gov.uk/idk/core/page.do?pageId=17092163; http://www.yorkshireeveningpost.co.uk/news/latest-news/central-leeds/leeds_makes_top_10_list_for_tourist_overnight_stays_in_uk_1_2115741; http://www.dailymail.co.uk/travel/article-1292707/Birmingham-Brighton-UK-tourist-favourites.html

117 http://www.nottinghamcity.gov.uk/index.aspx?articleid=14353

are long established but the point here is not over the rights and wrongs of such a measure, but that as the official policy of a Coalition partner, infrastructure represents a potential use should such a tax be implemented.

7.7 Pension Fund Investment

The 2011 Autumn Statement prioritised an ongoing dialogue with both public and private sector pension funds in order to leverage in £20bn worth of new investment into domestic infrastructure. A few weeks earlier, the Financial Secretary to the Treasury, Mark Hoban, had welcomed 'the news that UK pensions are building their capacity to directly invest in [infrastructure] projects. At a time of widespread market anxiety...infrastructure investment has the potential to offer those secure, sustainable and strong returns that investors are looking for.' With the government prioritising investment from both public and private funds, and with such funds adopting a gradually more positive position, it is worth outlining the overall terrain of such investment.

When discussing UK pension funds, it is important to note that we are discussing a large amount of money (similar in size to the annual national GDP) distributed over a large number of funds. The National Association of Pension Funds represents the interests of 1,200 separate groups ranging from funds with assets over £35bn to those in the tens of millions. Within the public sector alone, there are 101 separate Local Government Pension Schemes. There are questions regarding some form of amalgamation of the latter which will be covered in what follows, but achieving a quantum of any combination of these funds, it should be noted, is no simple task.

The total value of UK pension fund assets is estimated to be approaching £2tn – 90% of which is held by private funds. According to BNY Mellon, over the last 5 years the average weighted return for UK pension funds has been 3.2%, slightly behind RPI for the same period. It would have been better, in other words, to simply buy conventional government gilts (upwards of 4% returns were readily available) at almost any time during that period. These figures suggest two things – that private funds have the potential to play a large role in any future infrastructure investment through a relatively minimal allocation of their capital, and that all pension investors may profit from seeking safer financial choices than equities (i.e. the stock market) in the coming years, if only to counterbalance other, riskier, investments. At present it is estimated that less than 1% of UK funds' portfolios cover infrastructure – for a relatively minimal reallocation of resource, the win of stable and predictable cash flows over the long term should prove tempting.[118] The FTSE100 index and private svector employer pension schemes alike fell by around 30% in value due to the economic crash of 2007, and the various Local Government Pension Schemes, as we will see, suffered similarly high losses of up to 28% over the 2007-2009 period.

According to the OECD, pension fund investment in infrastructure is driven by four major factors:

- the increasing availability of investment opportunities for private finance capital;
- the maturity and size of the pension fund market;
- market regulation (or lack thereof)
- the learning curve a nation has undergone in regard to such investment.[119]

Through, respectively, the experience (positive and negative) of PFI, a relatively aged population (and therefore a large pensions market in both public and private sectors), and almost no regulation with regard to pension fund asset

118 *FT*, 25 November 2011.
119 Ibid, 22-23.

allocation, it seems the UK is relatively well placed to fulfil these first three criteria. On the other hand, it does seem that there is still a way to go meet this final criterion; actual investment – rather than theoretical capability – has remained limited, certainly compared to international comparison.

7.8 Global context

With global infrastructure requirements to 2030 estimated to be in excess of $50tn (US), numerous countries around the globe have utilised pension funds to pump prime development. As private capital shrivelled up during the peak of the financial crisis, and new regulations such Basel III (which raises the level of capital banks must hold, and thus affects what they can lend) take effect in the coming years, the importance of pension funds to drive infrastructure investment will only increase. At present, pension fund assets make up around a quarter of all global institutional investment funds, and have been steadily growing in importance.[120] Canada and Australia offer some particularly interesting examples.

Several Canadian pension funds have sought to invest in infrastructure – mostly, until recently, abroad. Whilst a 10% ceiling on the share of assets that Canadian funds could invest outside of the country was instituted in 1971, and extended to 30% three decades later, most firms circumvented such regulations through the use of financial derivatives. Ontario Teachers Plan, for one, took a minority stake in Birmingham Airport in 2007. Another such fund, the Ontario Municipal Employees' Retirement System (OMERS), has shown how a local government pension plan can take an active role in domestic infrastructure investment.

OMERS

Through an investment arm, Borealis Infrastructure, OMERS has committed (as of December 2010) C$8.3bn, or around 16% of its total assets (C$53bn) to various forms of infrastructure (including High Speed 1 in the UK). Through steadily increasing their stake (and investing alongside private companies), OMERS has gained the type of knowledge and expertise that can arm them in the market as regards future investments, and achieved a 12% return in 2010.

Australia has also seen local government set up investment vehicles for its pension funds, and these have helped drive infrastructure investment both at home and abroad.

Queensland Investment Corporation (QIC)

QIC, formally established in 1991, has over 80 institutional clients and A$60bn in funds under management. Owned by the State of Queensland, its preference is to invest in the Australian infrastructure market – and, as of June 2010, 41% of its capital in the infrastructure portfolio was invested in Europe, and 48% in Australia/New Zealand. Whilst this was mainly invested in larger scale projects such as water (23%), airports (21%) and ports (10%), such an investment arm could also be feasible for English local authorities.

120 See Pension Funds Investment in Infrastructure: A Survey, OECD, September 2011, 15-18.

These local government vehicles apart, sovereign wealth funds have become more of a factor in recent years. In the UK, the South Korean National Pension Service has taken a 12% stake in Gatwick Airport, whilst that nation's Military Personnel Pension Service has invested over £250m in buying almost 7% of Thames Water. Former US President Bill Clinton has recently urged his government to attract such funds into US infrastructure. Foreign investment is one way to stimulate the economy (and for larger schemes with potentially attractive yields is a possibility), but there may be mileage – and certainly more control – in ensuring domestic pension schemes invest in the UK, as we will note.

7.9 UK private sector investment in infrastructure

Foreign investments aside, there is more that private pensions can do, and be encouraged to do, in terms of infrastructure. To date, even the largest two private funds in the UK are indicative of a reticence towards such investment. Though the USS, below, is raising its allocation, even should it meet its proposed target it will still lag over three times behind the Canadian OMERS scheme.

Private Sector Pension Investment: the University Superannuation Scheme (USS)

From its first investment in UK infrastructure in 2005, the USS – the second largest private pension scheme in the UK – raised its investments in this area to almost £800m by 2010. With assets of over £30bn, the USS is targeting a 4-5% allocation to infrastructure which means such investment will need to double in the coming years.

If the government's aim of 70% of future infrastructure investment coming from private sources is to be met, then the private larger funds will need to be brought on board. Talks, as mentioned, are ongoing. The BT scheme, below, illustrates the scale of the challenge.

Private Sector Pension Investment: BT Pension Scheme (BTPS)

The BTPS, the UK's largest (£37bn) and by reputation one of the more adventurous schemes, has recently made a £315m investment into renewable energy infrastructure markets. Though that recent intervention is to be welcomed, its total investment commitment to infrastructure still stands at around £500m – around 1.5% of its total asset value.[121]

Despite these faltering moves towards greater private sector interest in infrastructure, more it seems can be done to attract them into such markets.

7.10 Forms of investment

Since private funds hold by the far the greater amount of pension fund assets, there will be a need to coax them (and indeed other forms of private capital) into the infrastructure market. Private pension fund trustees are told that their 'first loyalty must be to scheme beneficiaries and [they] must always act in

121 *FT*, 28 November 2011.

their best interests.'[122] The job for government both central and, this report argues, local, is to create the conditions where this means investing in domestic infrastructure. Government of either type (and best, this report argues, some combination of both), can facilitate this in two ways:

- **Underwriting** private sector investment through mezzanine debt schemes. This would in essence involve the government guaranteeing lenders that they would be paid out first should any project collapse, and thereby make projects less risky in the construction stage (where most projects fail, and where the bond market is fearful). This would require little up-front capital from the government, but would involve an element of risk for no (direct) benefit – the overarching gains from national infrastructure aside.

Mezzanine Debt Products

Any investment choice weighs up a balance of risk and reward. In the present climate, the risk inherent in certain projects is putting off the private sector from lending money to finance infrastructure projects. In, say, a £50m proposal to build a waste treatment plant, funds might be split between 10% equity (£5m) and 90% (£45m) borrowing. This leverage would immediately put off investors fearful that the project would collapse before completion. Yet if this equity stake could be raised to 30%, lenders would be much more likely to lend to a ~3:1 ratio. A mezzanine debt product would see some party (for example, the GIB outlined below) guarantee this additional 20%, and thereby provide investors with confidence that their money would return. The Government's recent 'credit easing' programme is of a similar vein, in that by guaranteeing £20bn of loans to small businesses, they help reduce the rate at which said businesses can borrow.

- **Directly investing** alongside private investors in some form of pari-passu partnership. Pari-passu equity forms a co-investment product designed to encourage private capital in situations where senior debt (lending), again, is limited. This involves entering at a more immediate level – the initial equity – but would also serve to de-leverage, i.e. necessitate less, private sector debt. As with LABVs, it would also involve the potential to share in any future profits accrued. The risks and rewards would therefore be shared.

Pari-passu investment

Pari-passu, in the original Latin, translates to 'on an equal footing.' Adapting the above £50m waste treatment plant example, there is also the option to invest at the equity stage of the project, and directly invest £5m to double the total equity to 20%. This would provide greater reassurance to lenders that such a project would not collapse at an initial stage (and thereby again see better rates of borrowing on offer), and return 50% of any profits the venture would accrue. Should the project collapse however, having invested pari-passu would mean finding 50% of monies owed to lenders.

122 http://www.thepensionsregulator.gov.uk/trustees/role-trustee.aspx

Vince Cable has spoken of the need for government to give the right market signals to facilitate private sector investment. By investing money in the initial stages of infrastructure projects, and guaranteeing private sectorlending, central government can take a lead here. The Green Investment Bank, below, is a start.

The centre facilitating infrastructure investment: the Green Investment Bank (GIB)

The GIB is to be capitalised by £1bn of central government money and £2bn from asset sales (principally related to High Speed 1). According to various ministerial pronouncements, whilst facilitating greater levels of green investment it will have the following characteristics:

- It will 'be run on a commercial basis, free from day to day ministerial interference'
- It will make its first investments from April 2012
- The £3bn of up-front capital is intended to lever in an additional £15bn of investment
- Providing 'additionality' – responding to a lack of market demand – is a key driver

The GIB will undertake both pari-passu and mezzanine investment. Though positive, there are two ways we argue this could be augmented. The first is to create a larger investment institution with a remit that covers both wider forms of infrastructure, and sees a greater up-front capitalisation. We discuss this at the end of this chapter. The second would see a more dynamic approach being adopted by the various local government pension schemes, and to that we now turn.

7.11 Investment from the Local Government Pension Schemes

To encourage the private sector pension funds to invest their capital into infrastructure projects there may be a significant role, GIB aside, for the 101 local government pension schemes to play. There are two forces at work here. The first is a need for public sector pension funds to respond to shifting demographics. The recent rise, triggered by the economic downturn, in early retirements has led to a small increase in benefits paid out by Local Government Pension Schemes (£6.7bn in 2010/11 compared to £6.3bn in 2009/10) whilst its income from contributors has stagnated (£1.97bn in both years). As total income to the various LGPSs rose from £10bn in 2005/6 to £11.5bn in 2010/11, investments have made up an increasingly small proportion of its income.

Local Government Pension Schemes Income (as % of total income)

	2006/7	2007/8	2008/9	2009/10	2010/11
Investment Income	30	29.8	26.6	23	23
Investment Income excluding property and other income	25	25.6	23.6	19.2	18.2

At the same time, speaking to authorities, it was clear that the global financial situation has engendered an understandable risk aversion when it comes to investing pension monies into the markets. Between 2007 and 2009 the various LGPSs lost around £14bn through their investments.[123] Exposure to Icelandic Banks and Lehman Brothers accounted for some of this, but the three worst affected funds had no exposure to these institutions. Given the role infrastructure may play in diversifying portfolios, it is worthy of note that the chair of the Audit Commission's pension scheme highlighted the 'wider diversification we have been able to introduce' which included, she noted, 'investing in infrastructure'.[124] Trading in the stock market will of course still occur, but there have been increasing calls to anchor such riskier moves to more stable, if lower yield, returns.

The California Public Employees' Retirement System – the largest public pension fund in the United States – has recently raised its infrastructure target allocation from 1 to 3% of its total portfolio, and there is good reason for English authorities to follow their example. With £900m worth of savings being required by the Local Government Pension Schemes by 2015, there is also, clearly, a pressing need to raise revenues. Part of this will come through increasing employee contributions by over 3% – though this may lead to some members leaving the scheme.[125] According to one local government pension scheme advisor, investing in infrastructure – particularly that with well evidenced income generating potential such as transport and energy – 'will become increasingly used by funds as we go forward.'[126] As the following data illustrates, though total income to the LGPSs has risen over the past five years so have benefits as a percentage of contribution receipt – and the demographics are thus shifting against the scheme.

Current LGPS Expenditure and Income

	2006/7	2007/8	2008/9	2009/10	2010/11
Expenditure on benefits	£4.8bn	£5.2bn	£5.6bn	£6.3bn	£6.7bn
Benefits as a % of contribution receipt	76.4	78.2	76.6	81.7	85
Total expenditure	£5.8bn	£6.2bn	£6.5bn	£7.6bn	£8bn
Total income	£10.1bn	£10.6bn	£10.8bn	£11.2bn	£11.5bn

Importantly, aside from the general need to ensure an increased return from its investment portfolio, there is an opportunity for local authority pension funds to coax private capital into infrastructure projects through the mezzanine debt schemes outlined earlier. Waste is one area where, as highlighted by Associate Parliamentary Sustainable Resource Group, there is a potentially key role for pension funds to play – particularly given the likelihood that all additional NNDR generated from new renewable energy projects will be retained locally. The problem, in essence, is that whilst 70% of overall investment in the waste sector must come from the private sector, the unwillingness of banks to lend represents a significant challenge here, as we noted in chapter two. The cost of bank debt has increased by at least a fifth (some estimate as high as a third) from pre-crash 2008 levels, and central government cannot always fill the gap – in 2010 funding for the Treasury Infrastructure Finance Unit as the lender of the last resort was ceased, and the October 2010 PWLB rate means borrowing from the centre will be far less attractive than hitherto. We discuss how the LGPSs may play a significant role in a new National Infrastructure Bank, below.

123 Somerset lost 28% of their fund, Harrow 27%, and Greenwich 25% during the 2007-9 period. Hammersmith and Fulham (5% rise) and the Orkney Islands (breaking even) fared the best.

124 http://www.paulgosling.net/2009/06/pensions-lose-14bn-local-government-chronicle/

125 http://www.gmb.org.uk/newsroom/latest_news/55_will_opt_out_of_lgps.aspx?theme=textonly

126 http://www.room151.co.uk/interviews/raisin-expectations-waltham-forests-lgps-advisor-talks-to-room151/

7.12 Current trends

Generally there are promising signs that LGPSs are going further with their commitments to infrastructure. Suffolk County Council's recent pension fund review stressed the need to allocate investment to areas with inflation linked returns (such as infrastructure, which in many instances can peg returns to inflation through maintaining a constant price for its usage above that level). As part of a move away from equities and the stock market, SCC has prioritised low-risk investments, including putting 2% into timber, and 5% into infrastructure.[127] Leicestershire CC is looking at similar uses for its pension fund assets during 2011/12, and both councils are indicative of a wider trend over the last two years.

Moves towards infrastructure (all comparisons 2009/10 to 2010/11)[128]

- Tyne and Wear Pension Fund has moved from a 1.5% allocation to infrastructure to a 2.5% allocation
- The Essex County Council Fund has moved from a 2% to 4% allocation
- Berkshire has increased its allocation from 1.9% to 3.2%

With £14bn lost in the crash then, local government pensions schemes are turning their attention to the more stable, if less spectacular, wins offered by domestic infrastructure. Whilst public transport and toll roads offer the chance to deliver infrastructure whilst ensuring a return, housing (particularly given it also leads to council tax and New Homes Bonus revenues) may prove an equally attractive option in the future.

Investment Opportunity: housing

Housing is one avenue where public sector pensions may seek to increase their direct investment. Barking and Dagenham have recently used a LABV – involving an institutional investor and developer – to build 500 affordable homes. In this case, the only up-front cost to the council is in the two plots it is provided for the scheme. For the private sector, there is the win of a guaranteed income stream – the council is guaranteeing rents on the scheme for 60 years, after which it will assume control of the properties – whilst, in the short term, the council augments its local housing stock.

Despite piecemeal moves towards infrastructure from the various LGPSs, the challenge remains how to drive investment from the sector as a whole. Amalgamating the 101 schemes into five funds of c.£30bn each has been discussed, as has a full merger.[129] Proponents of a merger into 14 regional funds have pointed to potential savings of up to £1.2bn respectively.[130] As the following illustrates, the LGPS is far from a single entity at present:

127 http://www.lgcplus.com/Journals/2011/09/12/q/t/u/LGC-Investment-Supplement-8-September-2011.pdf

128 All statistics from the various pension funds' annual reports.

129 *Professional Pensions*, 1 February 2012.

130 *The MJ*, 2 February 2012.

Asset Value of the 10 largest Local Government Pension Schemes

- Tameside (Greater Manchester) – £10.4bn
- West Midlands Pension Fund – £8bn
- West Yorkshire Pension Fund – £7.9bn
- Merseyside Pension Fund – £4.7bn
- Tyne and Wear Pension Fund – £4.3bn
- South Yorkshire Pension Fund – £4.1bn
- Lancashire County Council – £4bn
- Hampshire CC – £3.2bn
- Essex CC – £3.1bn
- Kent CC – £2.9bn

Whilst a full or partial formal merger of these funds would provide a suitable quantum, high performing funds may well argue that they have little to gain from such collaboration. Either way, a National Infrastructure Bank on the other hand, would, we contend:

- Avoid the legal problems of investing within any particular authority
- Achieve a level of capital which provides a greater range of potential investment options, and therefore greater returns for any given pension fund
- Convert a series of understandably conservative individual pension funds into a larger, pragmatic but pro-active, investment institution which would still retain each funds' independence

7.13 Towards a National Infrastructure Bank

In our survey, a large proportion of authorities expressed a desire to see a government sponsored investment bank pump prime the market. In November 2011, President Obama – with bi-partisan support – announced the creation of a national infrastructure bank in the United States, with the aim of leveraging in private sector capital.[131] A prominent advocate of such a policy on this side of the Atlantic has been the crossbench peer and economist Lord Skidelsky who has argued that the paradox of thrift (recession producing higher levels of saving) is stifling growth across the board. According to Skidelsky, any government investment bank would, as well as overriding this trend, achieve four key targets through an initial £10bn capitalisation. It would, he contends:

- Act as 'a strong corrective' to the market by avoiding 'short-term speculation'
- Directly lend and guarantee private sector loans to SMEs
- Invest in infrastructure and green projects

This £10bn, Skidelsky contends, could more than offset an £87bn reduction in public spending through facilitating greater private sector investment through the two options – pari-passu and mezzanine debt guarantees – discussed earlier. Yet there may be scope to go further than Skidelsky suggests, and the Local Government Pension Scheme can play a prominent role in this process, as detailed below:

131 http://www.whitehouse.gov/blog/2011/11/03/five-facts-about-national-infrastructure-bank

How to capitalise a NIB

Initial Capitalisation stage

- Central Government – £8bn through (wealth) taxation and/or Quantitative Easing (see next section)
- Local Government Pension Schemes – £4bn

Investment sources per year (over a four year period)

- Local Government Pension Schemes to commit to invest £2bn in NIB bonds
- Private Pension Funds to be encouraged to invest £2.5bn in NIB bonds

This would produce a NIB with Skidelsky's target of £10bn worth of capital within 2 years. Through their initial investment, the LGPSs could help shape the composition of the bank's board.

Using the above model, the LGPSs could help deliver capitalise a bank worth £30bn within four years, over twice Skidelsky's estimate. By gradually phasing in monies through this structure, the LGPSs would invest less than 3% of their asset base up-front, and an additional 1.5% per annum for four years. This institution has the potential to help deliver a majority of the £250bn worth of infrastructure required over the next few years. £30bn is only an initial estimate however, and government both local and national should impress upon pension funds that there are big, and secure, wins available by investing in this institution. We therefore recommend that private sector companies should encourage their pension fund trustees to increase their investment in UK infrastructure.

7.14 Benefits of the National Infrastructure Bank

As with pension fund investment, there is much global context on which to draw here. The Nordic Investment Bank – set in 1975 by five Scandinavian nations – has a mandate of 'promoting the competitiveness of the member state economies' and 'promoting a better natural environment.' Through its AAA Credit rating, in 2011 it was able to raise €3bn on the capital markets at favourable costs.[132] Though it possesses a green agenda, this has been broadly interpreted to include (in 2010) loans to purchase new trains to improve the Swedish railway, improvements to Finnish housing stock, and the design, building and operation of a hospital in Sweden.[133] Germany also offers a longer term example of how an investment bank can leverage in private capital to infrastructure investment.

132 www.nib.it

133 http://www.nib.int/filebank/1678-NIB_Annual_report_2010.pdf

KfW[134]

Kreditanstalt für Wiederaufbau (KfW) is a German investment bank set up in 1948. With ownership shared between central (80%) and municipal government (20%), long term loans at market conditions are extended to the latter of up to 50% of the investment cost of infrastructure. KfW acts primarily as a second tier bank, providing commercial banks with liquidity at low rates and long maturities, as well as with instruments to transfer risk. 90% of its borrowing occurs in capital markets, mainly through bonds guaranteed by the federal government. Of late, it has provided loans to 100,000 German families seeking to purchase homes, made €6bn available for infrastructure investment, and helped create or secure 124,000 jobs during 2010.[135] Global Finance has recently ranked the institution as the safest in the world.[136]

We believe the benefits of a similar institution in this country could be substantial. Importantly, though such an institution would separate from the government on a day to day operational basis, its proximity to the centre would make it very attractive to investors. In a still turbulent economic situation – as the Nordic Investment Bank shows – investors turn to safe havens, and any bonds offered by a British National Infrastructure Bank would be less risky than corporate bonds whilst offering a yield higher than government gilts. For private pension funds looking for secure havens for their capital, a NIB should provide an attractive option.

7.15 How to capitalise the NIB

Skidelsky has suggested two main options to find the up-front capital for any investment bank:

- The government should sell bank shares acquired in 2008
- It should issue gilts to be bought by the markets and/or the Bank of England

As for the first, losses (c.£400m) on the initial investment (£1.4bn) in Northern Rock have attracted much media coverage, but a mass sale of government shares in other banks would, according to recent estimates, produce an even greater loss – with the initial £60bn investment recouping less than half this amount.[137] Divesting a large proportion of shares now would thus lead to a big loss, and it therefore seems unlikely that the government will do this at the present time. However, should they decide to sell these shares, we would advocate putting the receipts into a national infrastructure bank.

The second option looks a stronger possibility. The February 2012 announcement of a £50bn new round of Quantitative Easing (QE3) could be used to purchase bonds issued by any NIB, though adding to the monetary supply would have an upward impact on an inflation level that is already around 4–5% – over double the Bank of England target (2%). As QE3 begins in earnest, a NIB should be the recipient of some of the monies involved. With £50bn set to be pumped into the British economy, a NIB would require only a fifth of this under Skidelsky's scheme, and less than this figure under ours – albeit showing signs of falling.

Both are potential options. We however contend that there is a greater role for the local government pension schemes to play, and there are two major advantages for these schemes here. Firstly, by investing in a national institution with a large

134 http://www.kfw.de/kfw/en/Domestic_Promotion/Our_offers/Infrastructure.jsp

135 http://www.kfw.de/kfw/en/I/II/Download_Center/Financial_Publications/Financial_publications/1_Geschaeftsberichte_E/20110610_Internet_KfW_GB10_EN.pdf

136 http://www.gfmag.com/tools/best-banks/2341-worlds-50-safest-banks-2009.html#axzz1gbzE67El

137 http://www.guardian.co.uk/business/blog/2011/oct/13/taxpayer-losses-rbs-lloyds-shares

capitalisation, local pension funds would be more likely to gain a better deal for their investors in future years (in the sense that any NIB would have more resource and financial expertise to leverage), and thereby likely to see more uptake from public pension schemes which have sometimes been a little reticent, understandably, to invest large sums in infrastructure. Secondly, a national institution would avoid the legal hurdles potentially inherent in investing directly in local infrastructure. A number of authorities we questioned are unclear on the legal terrain in terms of directly investing pension funds within their own authority (or even LEP) – and there is an issue regarding the conflict of interest between a council serving as the local planning authority whilst its members will in many cases populate both local authority and local pension scheme hierarchies. That is not to say that, where possible, authorities should not seek to invest their pension schemes locally, merely that any NIB avoids such pitfalls.[138]

The major point here is that local authorities should not sit passively and await the government to capitalise (or not) such an institution. By engaging meaningfully here, local government can help shape the argument for the type of national infrastructure bank that has the potential to both get the private sector out of its shell, and itself make strategic investments. It would need borrowing powers online prior to the current Green Investment Bank (i.e. before 2015), a degree of capital not yet pumped into that institution, and is, of course, a national rather than a local solution. Yet the benefits local authorities could enjoy would be substantial. If, as our survey indicates, central government pump priming the economy runs second (32%) only to bringing forward already scheduled capital expenditure (40%) in terms of methods to stimulate a private sector led recovery, a new investment bank – the GIB, but also a wider infrastructure institution – is worth serious investigation.

Recommendations:

- **The government should seek to capitalise a National Infrastructure Bank (NIB).**
- **The Local Government Pension Schemes should be prepared to invest an additional 8.5% of their assets (c.£12bn) into infrastructure, both in terms of funding local infrastructure projects and, perhaps more realistically (and easier to co-ordinate), capitalising and subsequently buying bonds issued by a new NIB.**
- **Central government hould encourage private pension funds to invest a small additional percentage of their funds (at least another 0.5% of total assets) in infrastructure, and particularly any NIB. Using the GIB (and any NIB) to facilitate investments would be a start, but the government can go further. Building upon recent public discourse, it should stress that responsible capitalism involves more than attaining the highest profit margin achievable on a day-by-day basis. Sustainability and the long term matter too.**
- **Private sector companies should encourage their pension fund trustees to increase their investment in UK infrastructure.**
- **The new round of Quantitative Easing, possibly in conjunction with any new wealth tax, should be used to encourage both local government and private pension investment in any NIB.**

138 In acquiring a single credit rating, a NIB would save £5m per year on the cost of 200 single ratings (if measured at a low level of £25k).

8. Conclusion

Over the next few years local authorities will face radically different circumstances than those enjoyed in recent decades. The purpose of this report has not been to sketch out an idealised landscape, but to address current realities and how authorities may make best use of them. The interview process for this report revealed both hopes and fears amongst council leaders, LEPs, and other key stakeholders. Greater financial autonomy is much welcomed in the local government sector, but the fact remains that there is less money to go around. Innovative thinking is required.

There has been much public debate about central government policy and how it may best drive growth in the short and medium term. This report contends that whilst such questions are clearly of vital importance, local government can do its bit in driving growth too, especially if it is given greater freedom to do so.

This report argues that the public-private relationship needs to be fundamentally recast. The mistrust engendered by the early, poorly negotiated PFI deals still hangs over the economy at precisely the time – for reasons of governmental priority and the need for growth per se – a more constructive and equitable partnership is needed. Local authorities should make intelligent use of their land, retaining fully what is unusable for development or may be of better use in years to come, but seeking to use land both within their current estate (and, through land auctions, land they may acquire) to attract private sector interest in driving development. This is about harnessing the expertise of the private sector, not kowtowing to its interests. There is nothing wrong with private sector profit, so long as the taxpayer sees the benefits too.

There is a balancing act here, clearly – and the new LEPs will have a crucial role to play. To date, they are already serving as an enabler of public-private dialogue and distributor of central government monies (such as the Growing Places Fund). Yet this report argues that by operating as a receipt pooling mechanism for CIL and NHB monies, they could facilitate cross-authority collaboration more generally.

As part of this new public-private reality, local authorities will need to move beyond a default reliance on the PWLB. This is not a question of ideology, but merely a pragmatic assessment of the rates on offer. Crossrail serves as an example where an authority – albeit a special case – was able to get a cheaper rate by tapping the bond market. By clubbing together for individual projects or as part of their LEP, authorities can make themselves an attractive entity for potential lenders, take advantage of English local government's implicit (and increasingly through the various individual credit ratings sought, explicit) credit worthiness, and thereby drive growth from the bottom. This will still require investments to be sustainable over the long run but, importantly, by thinking creatively authorities can help ensure the nation as a whole does not fall beyond in either short or long term.

Speaking to various authorities, it is clear that fears of speculative 1980s style playing of the markets remains a conceptual barrier for local authorities to enter the bond market. One way to alleviate such concerns is to legislate along the lines of the 2008 TfL Act – giving authorities the power to mitigate risk, but not carte blanche to gamble on market movements.

All this, in essence, boils down to risk management. These are difficult times, but precisely because the challenges are so significant this must spur local authorities into action, rather than seeking refuge. This, to be clear, does not mean pouring money into high-risk investments with no prospect of return – such a strategy would make little sense in times of plenty, let alone current circumstance. Yet, this report contends there is room for a pro-active strategy which can help redefine risk for all parties interested in driving growth.

By pump priming investment through the mechanisms this report suggests – borrowing to invest and grow – and using capital to de-risk investments for other parties (pension funds both public and private, the private sector itself, and central government) government both local and national, even where it cannot always take a leading equity stake. Growth needs capital flows and this cannot always be best delivered from on high.

This is not easy. The current government's aim to eliminate the structural deficit within the current parliament has given way to a longer term target of doing so by 2017, and all parties will fight the next election pledging to make spending cuts. This places severe limits on what local government can do over the next few years. Yet by using the options available to them in a creative manner – PWLB giving way to prudential borrowing for short term investment, and bonds for projects over the long run – local authorities can still drive investment, particularly where they act in concerted partnership – within their LEP, with the private sector, and with central government.

Central government can provide more strings to the bow of local government finance by, as this report suggests, creating a national infrastructure bank, pledging to capitalise it to a limited degree (involving less than a fifth of the sums in the third round of quantitative easing), and then inviting local authorities (and their pension funds) to make up the balance. This institution can then in turn attract private sector capital (particularly pension funds) seeking a financial safe haven. The concept of a national infrastructure bank is a non-partisan solution with significant global precedent which would help drive forward those investment projects which are currently in danger of collapse. By pump-priming now, growth can be delivered in the short and long term. Unlocking funds from both private and public sources will constitute a key facet of the coming years and, through a NIB, both would be rewarded with a secure investment for their capital.

The solutions to fund future infrastructure are out there, but will require some creative thinking and positive dialogue from all concerned parties. This report forms an attempt to stimulate such thoughts and discussions.

Appendix

To provide some statistical rigour to the findings within this analysis, we undertook a survey of all local authority leaders and chief executives within England. Precisely 100 such figures responded to the questions that follow. To ensure maximum response rates, respondents were free to skip particular questions, hance the percentages that follow.

1. On a scale of 1-5, would you describe your authority as cautious or ambitious in its future capital investment plans? [1 – Cautious, 5 – Ambitious]

Answer Options	Response Percent
1	11%
2	19.8%
3	19.8%
4	35.2%
5	14.3%

2. On a scale of 1-5, how do each of the following factors impact upon your present infrastructure plans? [1 – it forms a significant hindrance, 5 – it provides significant help]

Answer Options	**1**	**2**	**3**	**4**	**5**
Current availability of local developable land	12%	16.3%	33.7%	23.9%	14.1%
The level of financial autonomy currently held by local authorities	16.5%	29.7%	37.4%	13.2%	3.3%
The nature of existing infrastructure contracts	9.1%	27.3%	54.5%	9.1%	0%

3. Do you have any plans in place to consult externally on the pros and cons of various infrastructure finance mechanisms? (you may tick more than one)

Answer Options	**Response Percent**
Yes – from central government	25.6%
Yes – from the LEP	33.3%
Yes – from the private sector	27.8%
No	42.2%
Don’t know	10%

4. What three areas of infrastructure are you most looking to improve in the coming years?

Answer Options	Response Percent
Transport	74.5%
Communications	70.6%
Waste	41.2%
Schools	33.3%
Energy	27.5%
Hospitals	7.8%
Water	5.9%

5. What is the estimated value (£bn) of your total infrastructure investment up to 2015? [open ended]
6. As far as you can predict, what is the estimated value (£bn) of your total infrastructure requirements beyond 2015? [open ended]
7. Will you be making infrastructure investments primarily as a…

Answer Options	Response Percent
Local authority	87.5%
Local Enterprise Partnership	12.5%

8. Given the emphasis placed on a private sector led recovery, what policy do you think would most contribute to this?

Answer Options	Response Percent
Bringing forward already scheduled current capital expenditure	40.4%
Central Government pump priming the market (e.g. through a Green Investment Bank)	31.9%
Lowering the burden of regulation on the private sector	12.8%
Reforms to the planning system	12.8%
Expanding the number of sectors covered by a Regulatory Asset Base	2.1%

9. Do you plan to use the following mechanisms to help meet your authority's infrastructure requirements in the years ahead?

Answer Options	Yes – already use	Yes – we will do so	Probably	Maybe	Unlikely to	No	Don't know
Business Rates Supplement	0%	13.6%	9.1%	27.3%	27.3%	13.6%	9.1%
Business Improvement Districts	19.6%	6.5%	4.3%	15.2%	37%	15.2%	2.2%
Community Infrastructure Levy	10.9%	50%	19.6%	8.7%	6.5%	4.3%	0%
New Homes Bonus	25.5%	27.7%	14.9%	12.8%	12.8%	4.3%	2.1%
Business Rate localisation	2.2%	26.7%	20%	24.4%	13.3%	8.9%	4.4%
Tax Increment Finance (TIF)	2.2%	8.7%	21.7%	21.7%	21.7%	6.5%	17.4%
Private sector led TIF	0%	2.3%	14%	27.9%	30.2%	9.3%	16.3%
Enterprise Zones	4.3%	19.6%	10.9%	17.4%	21.7%	23.9%	2.2%
Bonds	0%	0%	8.9%	20%	26.7%	24.4%	20%
Regional Growth Fund	14.9%	14.9%	14.9%	19.1%	12.8%	12.8%	10.6%
European Regional Development/Social Funds	17.4%	13%	19.6%	15.2%	19.6%	10.9%	4.3%

10. Has your authority actively lobbied central government for more power/money being devolved to local authorities for the following mechanisms?

Answer Options	Yes	No	Don't know
Enterprise Zones	69.6%	30.4%	0%
Business Rates	67.4%	32.6%	0%
New Homes Bonus	63.8%	36.2%	0%
Community Infrastructure Levy	48.9%	46.7%	4.4%
Business Rates Supplement	32.6%	63%	4.3%
Tax Increment Finance (TIF)	28.9%	66.7%	4.4%
Business Improvement Districts	20%	80%	0%
Private sector led TIF	11.4%	81.8%	6.8%
Bonds	9.5%	81%	9.5%
Existing national taxes (e.g. income tax, stamp duty, VAT)	8.9%	86.7%	4.4%
Proposed new taxes (e.g. mansion tax)	0%	95.6%	4.4%

11. Do you think the Private Finance Initiative will provide a value for money funding option in the coming years?

Answer Options	Response Percent
Yes	2.1%
Probably	2.1%
Maybe	23.4%
Unlikely to	34%
No	38.3%

12. What do you feel could be most improved about PFI? [open ended]
13. Was your authority exploring the use of bonds prior to the October 2010 Public Works Loan Board rate rise?

Answer Options	Response Percent
Yes	10.6%
No	80.9%
Don't know	8.5%

14. The government has announced it will offer a reduced rate for PWLB borrowing related to paying down debt incurred by buying out of the HRA. Do you expect a significant amount of authorities will seek to use this rate for non-HRA purposes?

Answer Options	Response Percent
Yes	13%
Maybe	21.7%
No	23.9%
Don't know	41.3%

15. Would you be willing to join forces with other local authorities to issue a cross authority bond?

Answer Options	Response Percent
Yes – discussions are ongoing	4.3%
Yes – it seems very possible	8.5%
Maybe	51.1%
Unlikely to	25.5%
No	6.4%
Don't know	4.3%

16. Is your authority in favour of greater local retention of business rates?

Answer Options	Response Percent
Yes	31.9%
Yes – but would prefer an alternative model to the Government's proposals	48.9%
Maybe	4.3%
No	14.9%
Don't know	0%

17. Would you support a greater proportion of funds held within Local Government Pension Schemes being invested in the following?

Answer Options	Yes	No	Don't know
Local infrastructure projects	60.9%	23.9%	15.2%
National infrastructure projects	23.8%	45.2%	31%

18. Do you anticipate your council will make use of the General Power of Competence to act in a more entrepreneurial manner?

Answer Options	Response Percent
Yes	53.2%
No	14.9%
Don't know	31.9%

19. Do you welcome more private sector involvement in economic development?

Answer Options	Response Percent
Yes	76.6%
Somewhat	23.4%
No	0%

20. Has your previous experience of cross authority collaboration in economic development been positive?

Answer Options	Response Percent
Yes	27.7%
Mostly	29.8%
Somewhat	25.5%
Rarely	12.8%
No	4.3%

21. Are you happy with the geographic size of your LEP?

Answer Options	Response Percent
Yes	57.4%
No	38.3%
Don't know	4.3%

22. What should be the most important function of any LEP?

Answer Options	Response Percent
Attracting private capital from outside the authority	50%
Fostering cross authority collaboration	26.1%
Bidding for central government/European Union funds	19.6%
Lending private sector expertise to member authorities	4.3%

23. If there are any further comments you would like to make, please do so here

24. What is your current position?

Answer Options	Response Percent
Chief Executive	54.3%
Council Leader	45.7%

25. What type of authority do you represent?

Answer Options	Response Percent
County Council	8.7%
Metropolitan Borough	10.9%
Unitary	17.4%
London Borough	2.2%
District Council	60.9%

26. Where is your authority located?

Answer Options	Response Percent
North East England	4.3%
North West England	10.9%
Yorkshire and the Humber	6.5%
East Midlands	15.2%
West Midlands	10.9%
East of England	13%
Greater London	2.2%
South East England	21.7%
South West England	15.2%

"This report's conclusions are of direct relevance for central government and local authorities of all political persuasions. It is pragmatic, comprehensive and clear. It persuasively argues for the need to think differently; to embrace new funding mechanisms; to be bold and entrepreneurial in the public service. It deserves to be widely read, and carefully considered."
Jesse Norman MP, Member of the Treasury Select Committee

"Britain's dilemma is that its economy craves investment but its politics mandates fiscal retrenchment. With this report, Localis has produced concrete suggestions to break the bind. In particular, it skilfully highlights the great promise of establishing a national investment bank. By leveraging a limited pool of public capital in the private market we can satisfy both our economy and our politics. This is a valuable and timely contribution to the debate on economic recovery."
Lord Skidelsky, Crossbench Peer and Economic Commentator

"Local government needs to be ever more inventive to find the infrastructure finance necessary to boost local economies. This report is a timely and comprehensive contribution to addressing a vital national issue."
Cllr Sir Richard Leese, Vice-Chair of the Greater Manchester Combined Authority

"Councils have an increasingly important role to play in stimulating the economic growth the country needs and in delivering the infrastructure their localities require. This excellent report succinctly describes the variety of funding sources that can empower local government to achieve this goal, and highlights where further progress is necessary."
Cllr Ravi Govindia, Leader, London Borough of Wandsworth Council

"The Coalition Government is rightly shifting power and money from Whitehall to local authorities and local enterprise partnerships across the country. Giving cities, counties and LEPs greater potential to shape their localities can help drive a new wave of infrastructure investment, create growth and jobs, and fundamentally reorient our economy for the better. This report, brimming with interesting ideas, should be read by all those interested in building a stronger and more balanced economy, and I welcome its entry into the wider public debate."
Lord Shipley, Liberal Democrat Peer and Government Cities Advisor

LOCALIS

www.localis.org.uk