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To: Environment, Highways & Waste Cabinet Committee

Date: 23 April 2013

Subject: New Funding Streams

Classification: Unrestricted

Summary:

An examination of alternative funding streams that could be used to fund new infrastructure developments and improvements.

Recommendation:

Members are asked to note and comment on the emerging funding changes for infrastructure development and improvement outlined in this report.

1. Introduction

1.1 There have been significant changes to the funding arrangements for local government which impact on both the day to day revenue budget and the capital programme. This report examines the changes and in particular identifies opportunities for funding infrastructure developments and improvements.

1.2 The changes must be considered in the overall fiscal context of a shrinking public sector as the Government seeks to eliminate the budget deficit and reduce the size of the public sector within the overall economy by reducing public spending as a proportion of the Gross Domestic Product (GDP). The early strategy outlined in the 2010 Emergency Budget and subsequent Spending Review 2010 (SR2010) set out significant reductions in both revenue and capital spending over a four year period with reductions for local government "front loaded" with greater savings in the first year.

1.3 The Autumn Statement in December 2012 heralded further 2% revenue reductions for 2014/15 (in addition to the reductions already included in SR2010) as the deficit was not reducing as quickly as earlier forecasts. The Autumn Statement also included an additional £5.5bn of capital spending for the remainder of the spending review period (2013/14 and 2014/15). Members of this committee will be aware that this additional capital funding includes the extra £6.273m we have put into the capital programme arising from KCC's share of the £215m allocated to local authorities for highway maintenance (the Highways Agency also received an additional £118m for strategic routes).

1.4 This shift in emphasis from revenue to capital spending was further extended in the Chancellor's Budget Statement on 20th March when he indicated that spending reductions would need to continue into 2017/18 to meet revised deficit reduction targets, and there would be a further switch of £15bn of spending from revenue to capital over the five year period from 2015. As yet we have no further detail on departmental allocations of this additional capital but it is indicative of the Government's shifting emphasis towards more capital infrastructure spending.

2. New Local Government Funding Arrangements

2.1 New arrangements for the treatment of business rates were introduced in 2013/14. Previously all of the business rates collected by local authorities were pooled and redistributed by Formula Grant (which also included a small top-up from Revenue Support Grant -RSG). Under the new arrangements 50% are pooled (and redistributed as new RSG) and the remaining 50% retained locally.

2.2 RSG will be allocated according to a baseline determined largely from the old Formula Grant methodology. This baseline will not be recalculated for population (or any other) changes year on year. This means that not only is the existing redistribution between authorities now crystallised into the new arrangements, but those authorities with a growing population/needs will not receive any additional RSG to meet additional demand on revenue funded services. Any such additional demands will have to be funded out of increases in the local Council Tax and business rates tax bases.

2.3 There are a number of other features and consequences of the new arrangements which are important to bear in mind in considering infrastructure funding streams:

- In two tier areas 80% of the retained share of business rates is attributable to the billing authority (District Council), 18% is attributable to the County Council and 2% to the Fire & Rescue Authority. A system of tariffs and top-ups ensures that this does not lead to redistribution in two tier areas against the baseline of the existing grant allocations (lower tier authorities paying a tariff and up tier authorities receiving a top-up). These tariffs and top-ups will be increased each year in line with the business rate multiplier (based on Retail Price Index).

- RSG will be adjusted each year to keep overall local authority spending within the spending review totals. Currently these spending review totals show a reduction and thus RSG will reduce each year for the foreseeable future. By law the government has to use all business rates to fund local authority services, and thus if it reaches the point that the RSG is less than the 50% of business rates pooled centrally, the balance will have to be paid to local authorities to replace other grants.

- Individual authorities with large increases in business rates will be subject to a levy. Authorities with large reductions will be cushioned to some extent by a safety net. In two tier areas the levy will only apply to the billing authority's share. The safety net ensures no authority can suffer more than 7.5% reduction in its business rate share due to fewer properties paying business rates.

- This complex system means the County Council can receive a small share of any increase in income from additional businesses paying rates in the area, but this would be substantially less than our share of the overall reductions in local authority spending. The County Council would also have to bear its share of the risk of any business rate reductions up to the point the safety net kicks in. The safety net would be applied across all 12 districts and thus a large reduction in one district could be offset by small increases in other districts resulting in the County Council not benefitting from safety net protection.

2.4 Overall the new arrangements means the County Council stands to gain very little from infrastructure developments which result in additional business rates, but could lose substantial sums from business rate reductions. The overall receipts from business rates and RSG will be declining for the foreseeable future, and this will put substantial pressure on the revenue budget meaning that additional prudential borrowing (the traditional way of funding infrastructure development) is likely to be extremely limited.

2.5 The scope to increase Council Tax also looks likely to be constrained by tight referendum requirements (although the County Council will still benefit from the lion's share of any additional Council Tax from new housing developments). These consequences of the new funding arrangements need to be taken into account when considering future infrastructure developments as these need to avoid putting additional strain on already stretched revenue resources.

3. New Homes Bonus

3.1 New Homes Bonus (NHB) grant will continue be allocated as a separate funding stream based on new housing developments and bringing empty properties back into use. New developments are measured according to the year on year increase in Council Tax base. Since there is a significant lead in time between planning being approved and developments being completed and included in the tax base, this means there is a lag in funding. This lag could hinder using NHB to fund infrastructure development.

3.2 The grant is not ring-fenced i.e. it can be used for any purpose. New developments will attract funding for 6 years which means we can anticipate the grant increasing in instalments between 2011/12 to 2016/17, but thereafter increases will be determined on new developments being larger than the developments dropping out. This is demonstrated in chart 1 below. However, after the initial injection of £250m in SR2010 this roll out is funded from top-slicing the

RSG settlement (and thus is not new money but simply recycling money from the old formula based on population to a new formula based on Council Tax base).

Chart 1

2011/12	2012/13	20/13/14	2014/15	2015/16	2016/17	2017/18	2018/19
2011/12 increased tax base	2011/12 increased tax base	2011/12 increased tax base	2011/12 increased tax base	2011/12 increased tax base	2011/12 increased tax base		
	2012/13 increased tax base	2012/13 increased tax base	2012/13 increased tax base	2012/13 increased tax base	2012/13 increased tax base	2012/13 increased tax base	
		2013/14 increased tax base	2013/14 increased tax base	2013/14 increased tax base	2013/14 increased tax base	2013/14 increased tax base	2013/14 increased tax base
			2014/15 increased tax base	2014/15 increased tax base	2014/15 increased tax base	2014/15 increased tax base	2014/15 increased tax base
				2015/16 increased tax base	2015/16 increased tax base	2015/16 increased tax base	2015/16 increased tax base
					2016/17 increased tax base	2016/17 increased tax base	2016/17 increased tax base
						2017/18 increased tax base	2017/18 increased tax base
							2018/19 increased tax base

3.3 80% of NHB is paid to district councils. The remaining 20% is paid to the County Council. Each year to date the county's share of NHB has amounted to an additional £1.4m to £1.5m and has been used to support the overall budget rather than a particular purpose.

3.4 It would be feasible to use some of the NHB to fund specific infrastructure development, but we would have to isolate the element for specific developments after taking account of the general top-slice from RSG. We would also have to negotiate with districts to contribute their share; to put the 20% county council share into context a 1,000 house development would generate less than £2m for KCC in NHB over the full 6 year period. We would also have to resolve the time lag issue and be satisfied that the funding will be sustainable under any future government.

4. Community Infrastructure Levy

4.1 The Community Infrastructure Levy (CIL) has been introduced as an alternative way for new developments to contribute towards the cost of public infrastructure. CIL is designed to work alongside and improve upon existing arrangements to levy developer contributions under section 106 of the Town and Country Planning Act 1990.

4.2 S106 only applies to larger developments and is negotiated between planning authorities and developers based on to type of development and the estimated infrastructure impact. The County Council can ask district councils to raise levies towards the county's infrastructure requirements at pre-agreed levels. Criticisms of S106 include lack of transparency between contributions paid and specific infrastructure projects, lack of predictability of the tariffs, and un-affordability of the levies on developers.

4.3 CIL can be raised on all developments based on charging schedule per m^2. The charging schedule is determined by the local planning authority (district councils) and unlike S106 they are not obliged to include county council infrastructure requirements. Charging authorities must have regard too the affordability of levies as regulations state that the "*must aim to strike what appears to the charging authority to be an appropriate balance between*" the desirability of funding infrastructure from the levy and "*the potential effects (taken as a whole) of the imposition of CIL on the economic viability of development across its area*".

4.4 S106 contributions and CIL cannot be raised to fund the same infrastructure requirements. The charging schedule should set out the types of infrastructure that will be supported by CIL, S106 contributions can only sought for specific sites which would trigger additional infrastructure needs over and above those set out in the CIL charging schedule.

4.5 The County Council is working closely with district councils to ensure that our infrastructure requirements are included within their CIL charging schedules and contributions are passed across in a timely manner.

5. Tax Increment Financing

5.1 We are expecting legislation to be passed which would enable local authorities in England to be able to use Tax Increment Financing (TIF) as a future source of funding infrastructure development. Currently TIF can only be used by Scottish authorities.

5.2 The localisation of business rates should make TIF viable. TIF enables the local authority to borrow against the additional business rate yield which would be generated from infrastructure schemes. The Government has announced that TIF will operate within a framework of regulations which are currently being developed. The Treasury is likely to be given the power for the final approval of TIF schemes and is likely to take a fairly cautious approach and may impose a borrowing cap on TIF schemes.

5.3 Currently local authorities are limited to borrowing within their existing overall revenue streams and have to make a prudent assessment of the minimum revenue provision (MRP) to offset against borrowing. Under TIF local authorities would be able to borrow against tax growth.

5.4 TIF is used widely in the United States by municipal authorities to fund infrastructure schemes. This operates under 3 models; local authority bonds which are secured against the additional tax yield, local authority borrowing funded from the additional tax yield, and developer borrowing which is funded by a grant from the local authority paid out of the additional tax yield. The last approach passes some of the risks from the local authority to the developer as grants would only be paid out of the actual additional tax yield.

5.5 It is envisaged that the additional tax yield used to support TIF would not only be generated from new businesses and developments attracted into the area, but would also include any general increase in rateable values in the local area.

5.6 We are awaiting further details of how TIF could be used by English authorities.

6. Conclusions

6.1 The new local authority arrangements include a number of opportunities for funding major infrastructure developments. However, these new streams will need to be tempered by the likely limitation on our ability to take out new prudential borrowing as the revenue budget continues to contract.

6.2 The new funding streams include:

- Additional government grants out of the £15bn switch from revenue to capital announced in the March 2012 budget
- Scope to use New Homes Bonus from specific developments to support infrastructure development
- Scope to negotiate CIL with district councils
- Scope to use TIF powers

6.3 At this stage there a number of issues to resolve with the new funding, particularly in relation to negotiating with district councils and potential timing issues with lags in funding.

Recommendations

Members are asked to note and comment on the emerging funding changes for infrastructure development and improvement outlined in this report.

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