Client Alert | Infrastructure

UK Infrastructure – Spring growth at the grassroots?

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Uncertainty remains over the infrastructure aspirations of the UK central government. As part of a series of articles on infrastructure, **Caroline Miller Smith, Partner at White & Case, London,** considers whether there might be opportunities in the UK at a sub-sovereign level that could be pushed forward.

With increasing uncertainty in the UK about the form Brexit will take, it is unsurprising that people have turned their attention away from the UK's infrastructure needs. But whatever happens after the end of March 2019, there will continue to be (and possibly more so) a need to demonstrate clear progress in meeting the social and economic infrastructure needs of the UK to maintain our competitiveness and respond to voter dissatisfaction with the status quo. Many commentators agree that in order to counter the effects of austerity, the government will need to rapidly refocus on its infrastructure plans post-Brexit; not just on "mega projects" but on more local projects.

What is the current position taken by the Government?

Notwithstanding the absence of a replacement delivery model for PF2, the Chancellor has committed to expanding the National Productivity Investment Fund from £31 billion to £37 billion, to extend it by a year to 2023 – 24[1] and confirmed that he remains "committed to the use of public-private partnership where it delivers value for the taxpayer and genuinely transfers risk to the private sector". The Chancellor has gone on to state that "half of the UK's £600 billion infrastructure pipeline will be built and financed by the private sector". [2]

In the Spring Statement on 13 March 2019, the Chancellor restated the Government's commitment to a National Infrastructure Strategy and published a consultation on Infrastructure Finance.[3] This note is focussed on infrastructure other than housing, but fixing "the broken housing market"[4] is re-emphasised as a priority and infrastructure plays a key part in that.

Can local government "take back control" of infrastructure provision?

Outside a traditional PPP model and centrally funded schemes, local desire for a "Brexit dividend" could refocus attention on using alternative long-term revenue streams in the hands of local authorities to fund infrastructure. New technologies and a low carbon agenda may also favour more local solutions to infrastructure provision. In addition, changes to the powers of local authorities appear to be gaining some traction.

1 https://www.gov.uk/government/publications/budget-2018-documents/budget-2018
2 https://www.gov.uk/government/speeches/budget-2018-philip-hammonds-speech
3 https://www.gov.uk/government/consultations/infrastructure-finance-review
4 https://www.gov.uk/government/news/spring-statement-2019-what-you-need-to-know

What sources of debt are available to local authorities for infrastructure projects?

Local authorities in England have of course been able for some time to borrow directly from the private sector to fund infrastructure within the constraints on capital expenditure imposed by legislation and the Prudential Code[5] or to borrow from the Public Works Loan Board ("**PWLB**").[6] However, legislation and guidance constrains the ability of local authorities to give asset specific security and limits them to giving security over their revenues.[7] Of course the funding of, and interest rates applied by, the Public Works Loan Board are dependent on central government policy[8] which makes the PWLB route the most cost effective for local authorities for the time being, and local authorities are not greatly incentivised to test a different avenue and develop more innovative structures based around new revenue streams.

The UK Municipal Bond Agency ("**UKMBA**") was created as a means for local authorities to raise money at lower rates of borrowing, by pooling together to create a "multi-billion pound" municipal bond market in the UK. Lenders would be reassured by lending across a diverse "pooled" spread of councils but uptake has been limited to date. As of 30 August 2018, just four councils have signed up to try to borrow a cumulative amount of £50 million.

Are there new ideas that could assist local authority infrastructure?

The National Infrastructure Commission in its report[9] last year recommended that local authorities be given further powers (through changes in legislation). There are a number of ways in which this could positively impact infrastructure provision, and the financing thereof:

- By allowing local authorities to retain more of their business rates, which could be used to fund infrastructure
- By permitting local authorities to add to council tax bills to fund infrastructure or supplement business rates, where the impact of infrastructure is positive on property values
- By allowing developers' contributions to be pooled together across multiple projects to create a larger fund for infrastructure investment.

It might surprise people to know that a number of the above proposals are already in place in the UK, in one form or another, which, with some further legislative steps, could help to fund local infrastructure.

How much of their business rates can local authorities retain?

To recap, business rates are a tax paid by businesses occupying non-domestic properties and form a substantial portion of local authority funding in England. Reforms to permit greater retention by local authorities of these business rates represent a significant opportunity to put both power back into the hands of local authorities and to enable them to use local tax revenues to fund their local requirements more effectively.

Retention of business rate revenue by local authorities is not new. Since 2013 – 2014, local authorities in England have retained 50 per cent of business rates (rather than accounting for 100 per cent to central government and having revenue reallocated)[10] From April 2017, the government has been piloting 100 per cent retention of real-terms changes in business rates revenues in a number of areas of England. From April 2018, a further 10 areas have been piloting schemes.[11] The government has announced plans to extend the broad retention scheme from 50 per cent to 75 per cent by 2020/2021.

In return for the retention of this revenue, the government proposes to transfer certain responsibilities to local authorities. This proposal has been criticised by some local authorities who are uncertain as to the extent of

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5 https://www.legislation.gov.uk/ukpga/2003/26/contents

6 https://www.dmo.gov.uk/responsibilities/local-authority-lending-pwlb

7 https://www.legislation.gov.uk/ukpga/2003/26/section/13

8 https://www.dmo.gov.uk/responsibilities/local-authority-lending-pwlb/interest-rates

9 https://www.nic.org.uk/publications/national-infrastructure-assessment-2018

10 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/778324/NNDR1_2019-20_Stats_release.pdf

11 Institute of Fiscal Studies report – https://www.ifs.org.uk/publications/12913

responsibilities to be transferred and the impact that an increase in retention to 75 per cent would have on their financial planning.

To make a transition to 100 per cent retention, legislation is required as the Local Government Finance Bill did not complete its legislative phases prior to the last election. The Department of Communities and Local Government is considering ways in which the Government's manifesto commitment to give local government greater control over their income can be taken forward.

What about infrastructure scheme-specific business rates or council tax supplements?

In addition to business rate retention, individual schemes such as Crossrail have used a business rates supplement mechanism, paid for by businesses above an agreed threshold, to fund the costs of expensive infrastructure. A supplement of this nature will eventually provide nearly one third of the cost of Crossrail 1. A majority of business ratepayers are required to agree to the supplement,[12] which is likely to be difficult to coordinate.

Taking it a step further, the approach taken with business rates supplements could be extended to council tax (non-business local taxation in the UK), so that a supplement could be payable calculated on the increase in property values resulting from new infrastructure. Protection could be afforded to existing residents by applying any supplement to new residents that move into the area. In this way, the supplement would be linked to the cost of improved infrastructure from which new residents benefit. However, extending the business rates supplements regime to include other non-business ratepayers would require changes to the definition of "non-domestic ratepayer" under the Business Rate Supplements Act 2009.[13]

City leaders outside London could adopt the Crossrail 1 funding model to raise funds for big infrastructure projects. The funding tools available to cities outside London are generally limited. Greater Manchester, for example, has had to "pool a range of funding sources, including local fundraising and borrowing against anticipated income, and to negotiate a bespoke deal with central government"[14] for infrastructure spending. Cities with smaller budgets find it hard to negotiate a sustainable funding model with the central government. Therefore, a flexible funding arrangement similar to the arrangement in London would provide cities outside London with "much more long-term certainty and autonomy" in designing and implementing infrastructure projects. Such a flexible approach has helped London to implement projects such as Crossrail, London Underground lines and the new Overground network.

Can Developers' Contributions and Community Infrastructure Levy (CIL) fund infrastructure?

In the past, "Section 106" agreements have proved to be a useful source of financial contribution made by a developer to local authorities. These financial contributions have been made to mitigate the specific impact of a new development. Funds can be applied to anything from new schools, health clinics to roads and affordable housing and in this respect are a revenue stream specifically targeted at local needs.

The benefit of such payments has been limited somewhat by a restriction on the ability to pool together such contributions across multiple developments, in order to create a larger funding pot capable of meeting more complex and expensive infrastructure requirements of developments. By doing so, this could facilitate more effective and bespoke funding solutions capable of greater local impact. The current Government's proposals would remove pooling restrictions in some cases, allowing local authorities to use Section 106 agreements more effectively.

Along similar lines, the Community Infrastructure Levy ("**CIL**") (introduced by the Planning Act 2008) is intended to be used to provide additional funding to local authorities to deliver the broader infrastructure requirements for developments in their area. Most new developments over a specified size are potentially liable for the levy but some developments may be eligible for relief or exemption from the CIL. This has the unfortunate consequence of making it an unpredictable revenue stream for local authorities.

[12] Section 8, Business Rate Supplements Act 2009

[13] Section 1, Business Rate Supplements Act 2009

[14] https://www.nic.org.uk/wp-content/uploads/December-2018-Next-Steps-for-Cities.pdf

To improve the way in which CIL might be applied locally, a change is required allowing CIL to be levied on a wider range of developments and in accordance with a published tariff schedule. Greater certainty is required and in that way, the cost of funding infrastructure could be better spread between developers.

Tax Increment Financing works in the US; can we adapt it for the UK?

In the UK, proposals to use tax increment financing ("**TIF**") were introduced in 2010 as part of the Chancellor's four year spending review to promote the regeneration of deprived areas. TIF is a funding mechanism by which local authorities issue bonds to fund their infrastructure and urban renewal needs, borrowing against anticipated increases in local business taxes from a particular area. Since 2010, local authorities have been encouraged to consider a TIF structure if they can demonstrate that the resulting infrastructure will deliver the growth required (and, more importantly, deliver the business tax revenue required to repay the bonds). TIF is a common structure used in the US and while it has been piloted as a structure in Scotland, it has yet to take off fully in England and Wales.

How might local tax growth be used to meet current infrastructure priorities?

The National Infrastructure Commission published the National Infrastructure Assessment ("NIA") in July 2018, and made broad brush recommendations as to the infrastructure priorities of the UK.

These include the following:

- **Low carbon energy** − Half the UK's power provided by renewables by 2030
- **Digital technology** − Nationwide full fibre broadband by 2033
- **Electric vehicle infrastructure** − National network of charging points for electric vehicles by 2030.
- **City growth** − Funding for major cities totalling £43 billion to 2040
- **Transport** − Major rail projects in London and the North of England
- **Flood management** – Nationwide standard of flood resilience by 2050

The Government has committed to respond to the NIC's recommendations and announce a new National Infrastructure Strategy in 2019.

Taking just one of the above sectors, Electric Vehicle Infrastructure as an example, the UK Government has already committed £400million to a Charging Infrastructure Investment Fund until 2020. At a local level, authorities have no duty to provide electric charging points but are able to decide based on local priorities whether to do so. This has the potential to match a decision to provide electric charging points with the ability to make a locally based tax decision: this could be an increment to business rates to supplement funding for the reinforcement of a private distribution network or the charging infrastructure itself.

Interdependencies between sectors, for example, urban planning and the need for housing, or localised generation and distribution infrastructure to satisfy an increase in electric vehicle ownership, will have an impact on the design and delivery of future infrastructure needs.

Conclusion

With PF2 and all manifestations of PPP being taken off the table as an option for local infrastructure funding, there is an opportunity for thought leadership which looks at the "grass roots" and the virtuous circle between development of local infrastructure, low carbon and digital technology goals, development of local business and increase in the value of property.

Central government can assist with this, through supportive policy but also through amendment to relevant legislation. Local authorities may need no encouragement to "take back control". There are many options available: after our protracted national discussion on Brexit, those responsible will need to start putting them into action.

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