

Tax Increment Financing

To: Joint Strategic Growth Implementation Committee

Date: 4 June 2008

From: Chief Executive, Cambridgeshire Horizons

Purpose: To offer the Committee some information on “tax increment financing” – a possible method for increasing early-stage funding for infrastructure in growth areas.

Recommendation: The Committee is invited to comment on the report.

Contact:	Name:	Alex Plant
	Job Title:	Chief Executive
	E-mail address:	Alex.Plant@cambridgeshirehorizons.co.uk
	Telephone No.	01223 714046

1.0 Tax Increment Financing

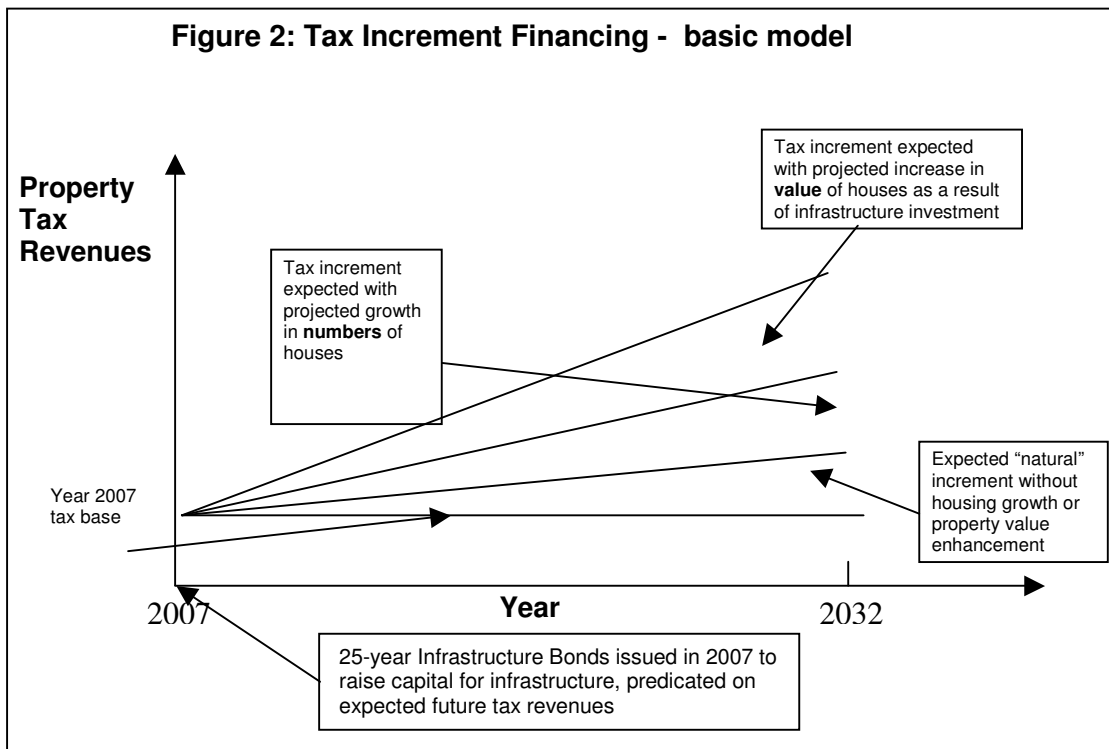
1.1 Tax Increment Financing is widely used by local government bodies in the US as a means of dealing with the problem of delivering infrastructure for growth ahead of the new homes being built. It is not a tool currently available to local authorities in the UK. This paper briefly describes tax increment financing and offers some thoughts as to its applicability in the UK.

2.0 Tax increment financing : how does it work?

2.1 Put simply, tax increment financing is an approach where a local authority (or a development corporation) raises finance up front against the expectation of higher property tax revenues flowing from three main sources:

- a) the expected “normal” uplift in tax from house price increases over time;
- b) the growth in the numbers of households paying the property tax, as new houses are built; and
- c) the additional appreciation in housing value that infrastructure investment usually delivers.

2.2 The diagram below illustrates how the scheme works.



3.0 Local Bonds

- 3.1 In the US tax increment financing model mentioned above, local bonds are the usual means of delivering the up-front capital needed for particular infrastructure, the bonds being repaid over time by the increased property tax revenues.
- 3.2 The local authority simply sells bonds into the market, thereby raising the capital, and then relies upon there being sufficient tax revenues to pay the dividend on the bond, and sufficient assets to cover the repayment of bonds at the end of the term. The credit rating of the bond-issuing authority (usually strong in the case of Local Authorities) is also a factor.

4.0 Why might this be of interest?

- 4.1 The particular attraction of tax increment financing is that it:
 - Enables the infrastructure to precede the housing;
 - Recovers the cost of the up-front investment from the asset (i.e. the housing) which itself generates the main need for the infrastructure in the first place and the value of which is enhanced by the infrastructure being in place;
 - Can help to change the psychology towards growth among people in growth areas as growth can more readily be seen to be something that enhances places, and the quality of life for people living there.
 - Provides a real incentive for local authorities to work with developers to deliver additional housing and higher quality communities because they will see direct financial benefit and greater control over the destinies of their communities through enhanced infrastructure funding
- 4.2 In addition, during my conversations with those local government representatives in the US who were using this approach, it also seemed that levels of engagement with the local electorate were also enhanced, and both elected and appointed officers appeared to feel very real ownership of their infrastructure programmes (rather than looking to Federal or State government for a lead).
- 4.3 Similarly it seemed that the greater financial and place-shaping power for US local government (compared to the heavily centralised UK system) can also unlock more dynamic and innovative approaches and help to attract talented people into all levels of local government. The success of this financing model in places like Portland, Oregon and many other cities in the US suggests that the UK should try to find a model that facilitates such an approach whilst fitting with the different political structures that operate in this country.

5.0 What would be needed to do this in the UK?

- 5.1 As mentioned, new legislation would be needed to enable local authorities in the UK to mirror this approach, not least because the council tax could not be used in this way and is not the equivalent of the US local property tax.
- 5.2 However, some limited variants of the model could be achieved within current legislation, as long as the local authority stayed within its prudential borrowing limits. This would depend on the availability and nature of other income streams. Were the County Council to introduce a congestion charge for example, it would be possible to borrow (or securitise) against the future incomes.
- 5.3 Local authorities could also use future increased business rates to raise finance and meet debt payments. Given the possibility of greater flexibility for Supplementary Business Rates, this might provide an option for Local Authorities, although how far this could replicate the benefits in the US property tax-backed system would depend on the rate set, and the quantum and timing of receipts versus debt repayment. However, particularly for larger urban areas, this might generate in excess of £100m over a typical bond period, so could be a significant element of any package of infrastructure investment.
- 5.4 A further possible impediment to adopting tax increment financing in the UK would be connected to the fact that borrowing would count against net public sector debt. Given the current fiscal tightness, and the concerns of Government to keep a cap on public sector debt, it is likely that large-scale increased borrowing by local authorities would not be permitted, but pilots in some of the fast-growing areas of the UK (such as Cambridgeshire) might be more palatable to the Treasury.
- 5.5 I believe there is some interest in this within Whitehall at official and Ministerial level, and should this lead to proposals for some pilot schemes, probably connected to business rates, then there may be merit in local authority partners in Cambridgeshire putting themselves forward.
- 5.6 The views of the committee are invited.