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TIF Uncovered

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Tax Increment Finance Uncovered or MIRED in the complexities of the BRRS?

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The relative absence of Government grant funding means that we desperately need revenue streams to fund infrastructure and growth. Tax revenues being used in this way are a new phenomenon in England if not Scotland. However, in England this source of finance is going to have to exist within a brand new system of business rate retention. The Local Government Finance Bill published at the end of last year sets down the framework although the details will be prescribed by the Government at a later date.

The current business rate regime requires local authorities to pool business rates collected by them by paying to the Government their respective non domestic rating contribution. The amount of contribution by each authority is determined by a complex set of rules. The business rates are redistributed through Central Government grant by reference to a needs formula. As such there is no opportunity currently for local authorities to use business rates growth as a financing tool

The Bill will change all of this by introducing the Government's new Business Rate Retention Scheme ("BRRS") (and afterwards the existing pooling provisions will only apply to Wales). The ability to raise finance against the future growth in business rates (tax increment finance) will be an integral and not separate part of the new BRRS. Tax Increment Finance will need to work within rather than outside the BRRS. It will take one of two forms either raising finance against business rates generally or alternatively against a defined business rate growth stream. However, things will not be simple as any borrowing will be undertaken against the backdrop of the potential for ongoing claw backs of rates by central government as part of the BRSS.

We all appreciate that full business rate retention will never be achievable. This is because for any business rate retention scheme to work fairly there must be arrangements in place which achieve a fair spread of business rates across local government. This will both protect those local authorities who have a low business rate base and avoid disproportionate benefits accruing to those local authorities who have a high business rate base.

This fair distribution will be achieved by a system of tariffs and top ups (calculated by reference to the previous year's baseline funding and business rates) which will be set for each local authority by Parliament in an annual Local Government Finance Report. This will determine each local authority's local percentage of business rates which it can retain. As an incentive for business rate growth tariffs and top ups will remain fixed in future years. However, even tariffs and top ups will not prevent future distortions arising, for example, from disproportionate growth deriving from large tax bases.

As a consequence the BRRS will also contain arrangements for the payment of a levy by those local authorities who gain disproportionate benefits. This will be managed through a Levy Account from which safety net payments will also be made to local authorities. Safety net payments are intended to fund support for local authorities whose income drops a set percentage below their baseline funding level.

However it appears even tariffs, top ups and levies are not enough as the Government also envisages a re-set of the system of tariffs and top ups every 10 years (or less) unless there are exceptional circumstances. This will give rise to potential further claw backs by central government.

So how does all this impact on tax increment finance for infrastructure? Whilst local authorities will in theory be able to harness potential business rate growth (it may be it is only the growth which can be used as the base is required for services) to forward fund infrastructure there will be an uncertainty for local authorities over long term cash flows as a consequence of the system of levies and re-sets. However, whilst this uncertainty may not inhibit prudential borrowing across authorities' rates income as a whole, nor borrowing within the re-set period (the first re-set will be after 7 years in 2020) nor prevent business rates being used as part of an investment fund, it will inhibit local authorities from securing long term loan finance on the back of a defined rates income stream.

As a consequence the Government has also stated that it is willing to exempt certain defined projects and schemes from the levy and re-set for a given period of time to enable traditional TIF style projects or schemes to proceed. The Bill has a provision enabling this on either an area basis or by reference to a type of building eg renewable energy. However, such projects or schemes will be the subject of a central HM Treasury approval process. The 24 Enterprise Zones are likely to contain some of the first pilots for this process and in addition the Government has awarded £150m of TIF funding to projects in the 3 Core Cities of Newcastle, Sheffield and Nottingham.

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How will this work? Once the BRRS is in operation each local authority will be allocated its percentage share of local business rates (taking into account tariffs and top ups). The authority will know its infrastructure requirement priorities. It will then need to consider how those priorities can be met from the forecast growth in business rates. Does the authority wish to borrow against only 7 years of business rate certainty? Or fund in some other way?

It will be open for authorities to pool their rates. Furthermore, whether the local authority decides to borrow or not it can still use other revenues eg CIL or section 106 contributions or New Homes Bonus in conjunction with the tax revenues. These revenues could sustain further borrowing or be used to prime an infrastructure investment fund. The potential for introducing institutional finance into TIF structures is interesting probably either through public sector bonds or risk spread funds. The more complex infrastructure and regeneration will require a mixed funding approach using business rates and TIFs alongside assets and other revenue sources.

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