

The Government announced in October 2010 that it would introduce new borrowing powers to enable local authorities in England to carry out Tax Increment Financing (“TIF”). TIF originated in the US where it has been successfully used for at least 50 years. Whilst it has evolved over time and varies from state to state, in general terms TIF allows a local government entity to take tax revenues derived from increases in property values or economic activity within a prescribed development area (the “TIF District”) and use those incremental revenues to fund infrastructure and other urban renewal projects. Key requirements are generally that the TIF District must be considered to be “blighted” and that “but for” the TIF no private commercial developer would undertake the proposed renewal scheme. The definition of “blight” has itself been expanded as TIF has developed in the US so that it can now simply refer to areas where economic development is being encouraged.

Before a TIF is established in the US the relevant local government entity will assess the suitability of an area for TIF and then produces a TIF development plan. The sponsoring local government entity then usually issues bonds to provide the funds necessary for the upfront project costs. As the TIF District is enhanced property values and, hence, property taxes rise and this additional revenue is used to service the TIF bonds. Sales tax and other local taxes may also be used in a similar way. Accordingly, detailed financial modelling must be carried out to satisfy prospective lenders that, on a conservative basis, there should be sufficient revenues to meet debt payments. TIFs are long-term commitments, often lasting 25 years or longer. During that time projects may be re-financed, reflecting changing levels of risk as projects are completed and mature. Once the initial debt has been repaid surplus TIF fund may be re-invested in the TIF District.

A notable feature of the US system is the level of local democratic control over local taxes. Each city and county controls the levels of tax it levies and will often seek a mandate from its electorate

for a specific increase in local taxes to cover the cost of a TIF project. It is interesting to note that one of the main drivers for the widespread adoption of TIF in the US was a reduction in Federal funding for urban projects combined with a greater devolution of power to local government levels.

In the UK the debate on TIF has focused on the use of business rates to the exclusion of other revenue sources, such as council tax. However, the major stumbling block is that the current business rate system is centrally controlled by the Government. The national non-domestic business rate (NNDR) is levied at a single national rate set by the Treasury, indexed to the Retail Prices Index with the underlying property valuations carried out by the Valuations Office Agency. At present local authorities have no discretion to raise local business rates and act simply as tax collectors for the NNDR with the Treasury returning funds to local authorities in the form of various grants.

The Local Government Resource Review which was launched in July contains the Government’s proposals to change the system of NNDR as from April 2013 to enable a degree of local retention of NNDR thus removing the main barrier to the introduction of TIF. Under the new system a baseline of income for a local authority will be fixed and there will be a system of tariffs and top ups to re-distribute revenues between local authorities based on whether the NNDR currently generated locally is likely to be more or less than is needed to fund a local authority’s activities. Theoretically a local authority will retain any additional business rates generated in its area, providing an incentive to generate local economic growth. The system will, however, be subject to periodic “re-sets” which may result in a local authority having its baseline NNDR revenue reduced in future years and there will also be an ability for Government to recoup any “disproportionate benefit” achieved by any authority which is being too successful! The consultation document issued by the Government does recognise that local authorities and developers must have a degree of certainty about future tax revenue streams to enable them to borrow against them. The Government has therefore proposed two scenarios within which TIF could operate:

- The first would allow local authorities to decide for themselves whether to invest in a TIF and they would be free to borrow against all of their retained business rate revenues, including anticipated growth, subject to the normal operation of the prudential borrowing system. However, these revenues would be subject to the levies and reset mechanisms in the new system so a degree of uncertainty would hang over these revenues in the future;
- The second would involve Treasury controls over the ability to bring forward TIF schemes but would guarantee that additional revenues generated in a TIF District would be ring-fenced and would not be subject to the levy and re-set mechanisms.

In the case of Enterprise Zones (EZs), the Government has confirmed that any uplift in NNDR revenues within the EZ above the current baseline can be retained for 25 years from April 2013 to support the purposes of the local enterprise partnership. The local partners will therefore be able to borrow against their future revenues without the need for Treasury approval and, effectively, the EZs will be “oven ready” for TIF. The Government has also confirmed that all revenues from renewable energy projects will be retained by local authorities under the new system.

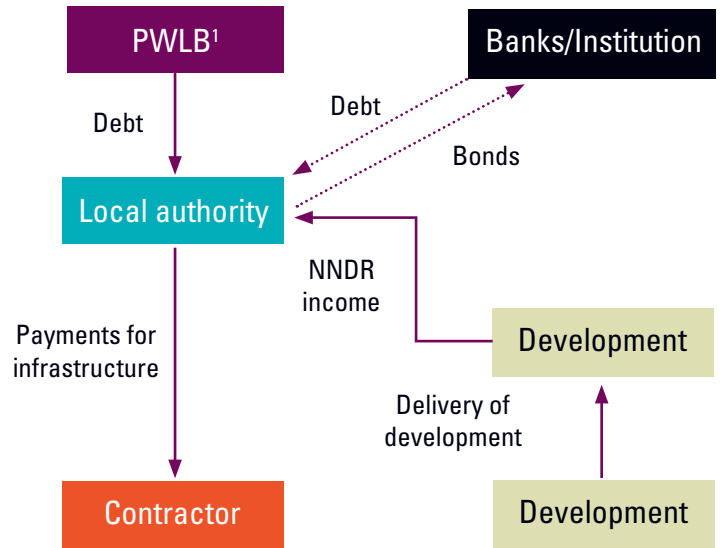
The British Council of Shopping Centres (BCSC) recently wrote to the deputy Prime Minister calling for the early introduction of a developer led TIF model known as the Local Tax Reinvestment Programme (LTRIP). This would not require any borrowing by the local authority but would instead be based on the developer financing the project out of its own resources and then being repaid out of the tax increment generated from the increased NNDR as and when it arises. (Please see Figs 1 and 2 which illustrate the potential local authority led and developer led TIF structures.) This model is commonly used in the US and has a number of attractive features from a public sector perspective notably that the developer takes the risk of any shortfall in incremental revenues generated within the TIF District. Another potential attraction is that the borrowing should be “off balance sheet” so far as the public sector is concerned, although the BCSC has noted a prevailing view within the Treasury that any “securitisation” of future business rates by a local authority would still be classified as government borrowing. However, the introduction of this model is not possible until local authorities are given powers to retain additional business rates so this is not a model that can be implemented without primary legislation. (The BCSC has highlighted statutory powers to retain business rates which are contained in the Local Government Act 2003 but it seems unlikely that the requisite secondary legislation will be brought forward to activate these powers.)

It must be acknowledged that TIF is not a panacea for town centre schemes or indeed any other type of regeneration or renewal project. The current challenging market conditions will not be conducive to TIF in many areas. TIF is best used where there are strong prospects of growth in the medium term and therefore it may be particularly appropriate in enterprise zones. However, TIF has been highly successful in the US and there is no reason why it should not be deployed in the UK once the NNDR system has been revised to allow some local retention of business rates. It certainly deserves to be given a chance to help drive the Government’s growth agenda at a local level.

For further information please contact the following:

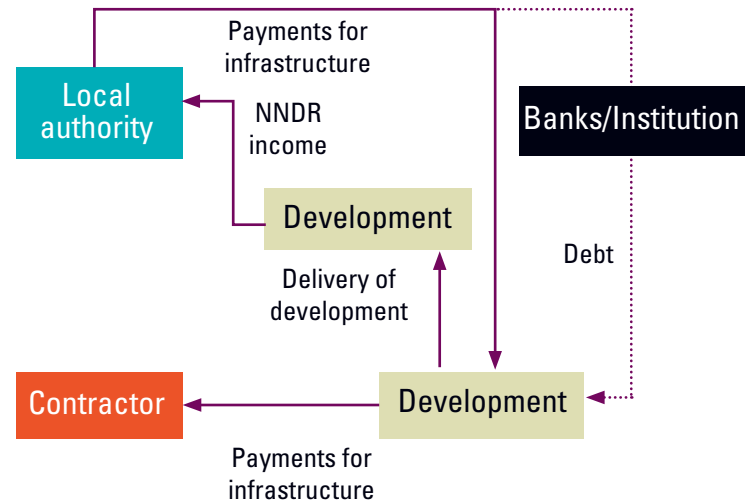
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Local Authority led TIF



¹ Public Works Loan Board

Developer led TIF



This article first appeared in ‘Investment Property Focus’ the journal of the Investment Property Forum.

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