SOUTH EAST ENGLAND COUNCILS &
SOUTH EAST STRATEGIC LEADERS
JOINT MEETING

Date: 30 June, 2016

Subject: **Funding infrastructure to maximise South East Potential: Work by Local Government Futures**

Report of: Neil Border, SESL Head of Policy

Recommendations:

i) Note Local Government Future's estimate of a £26bn infrastructure funding gap by 2030.
ii) Provide initial thoughts on the approach that Local Government Futures suggests (paragraphs 9, 14 and 15) including filling the funding gap by mixing investment sources.
iii) Provide initial thoughts on suggestions in paragraph 20 towards building a South East case for removing restrictions to free-up more infrastructure investment.
iv) Agree that SESL and SEEC officers follow up the recommendations and ideas in the LGF report with a view to preparing a package of ideas for discussion with the Government.

Introduction

1. South East Strategic Leaders (SESL) and South East England Councils (SEEC) jointly commissioned Local Government Futures (LGF) to produce a report on ways to fund infrastructure to support the South East's economic potential and meet the needs of its large and growing population.

2. To assist members in considering how local and central government should together support investment in infrastructure, and the changes needed to enable this, LGF was asked to:-

- investigate recent and emerging assessments of infrastructure requirements to estimate the South East funding gap;
- consider locally-funded and Government-funded investment opportunities to fill the gap;
- analyse the extent to which investment is and could be funded from local taxation growth across the South East; and
- advise on risk, funding potential, affordability, distribution of funding, as well as the potential role of devolution deals.

3. LGF was also asked to make recommendations on:-

- opportunities that South East councils could develop further;
- additional data and information that South East local authorities could potentially collect and develop in order to make a stronger case; and
- an outline high-level strategy for engaging with the Government.

4. LGF's final report will be used by SESL and SEEC to influence Ministers and other decision makers and inform member authorities' own funding options. The key objective of commissioning the report was to give Leaders clarity on what more local authorities can do and give options on future opportunities to explore.

Key findings of LGF's work

5. A growing population and a growing economy both place increasing pressure on infrastructure in the South East. LGF reviewed studies by some South East counties to estimate a **total South East infrastructure need of £55 billion by 2030**. Of this, a total of some **£26bn by 2030 cannot be funded from the existing resources** available to local public bodies, equivalent to £2,939 for every current resident of the South East.

6. More than half the total costs would be for transport. Education, health and social care, utilities and flood protection would also be significant. An Annex at the end of this paper lists the types of infrastructure provision and costs that LGF considered in its work.

LGF's report looks at how current funding options and new opportunities could be used to address this £26bn funding gap. It also outlines where additional support is required from central government, either with financial contributions or changes in funding systems.

7. LGF reports that recent years have seen changes in the role of local authorities and a greater expectation, and willingness, that they will take the lead in identifying and funding local infrastructure requirements, for example by shouldering greater financial risk. The Government has supported this change, for example through:-

- devolution deals in some parts of England which include the devolution of infrastructure funds and the responsibility for delivering wider economic growth; and.
- local retention of business rate growth and enhanced incentives for house-building.

8. It is essential that the South East can provide the infrastructure it needs sustain economic and population growth. The South East is a net contributor to the nation's finances. In the most recent figures available, it was estimated that the South East generated resident-based revenues of £88.5bn compared to total public expenditure of £84bn (2010-11). This translates into a fiscal balance of £4.5bn, which is second only to London. Since 1999, the South East's net fiscal contribution has averaged +£10.2bn per year and is expected to return to its pre-recession levels, when the net annual fiscal contribution was between £10-20bn. Projections by the Office for National Statistics expect 11.2% population growth in the South East between 2015 and 2030, which would see the population rise from 8.92m to 10m.

9. LGF suggests that **creating a viable solution to the infrastructure gap will require local authorities in the South East to consider a series of questions**, as listed below.

- Are the infrastructure requirements reasonable? Can they be delivered? Are they necessary and essential to the economic and population growth that is forecast? LGF warns they may be seen as the top end of what is credible and achievable.
- Can the investments within the infrastructure gap be prioritised?
- Have the local authorities and their partners done everything that they can from local resources to close the gap?
- What does the Government need to do to help the South East deliver its infrastructure requirements and to facilitate growth? What does the Government need to change to help the South East help itself? What direct financial support is required from the Government? Does it have fiscal implications for the Treasury?

A way forward for South East local authorities?

10. LGF calculates that the annual infrastructure investment need is around £3.6bn (£55bn over 15 years) and the funding gap is £1.7bn per year (£26bn over 15 years). LGF suggests that there are two significant elements to developing a way forward:-

- filling the infrastructure funding gap by mixing investment sources together (see paragraphs 11-17 below); and
- engaging the Government in discussions with a view to removing restrictions to free-up more infrastructure investment (see paragraphs 18-20 below).

11. LGF notes that local authorities could look to their own resources to fund those services that are core to its responsibilities, such as social care. LGF adds that this is a narrow viewpoint because it avoids the wider place-shaping responsibilities of local government. However, it might help to allocate certain funding streams to certain types of infrastructure requirement.

12. For the South East, LGF states that a key feature of addressing the infrastructure funding gap is that **growing tax revenues - the result of growing population and economy - could be reinvested into the infrastructure required to support that growth**. It is recognised that some equalisation is required within the funding system, and its effects should be predictable, so that taxation growth can be reliably re-invested.

13. Local authorities could simply ask the Government to increase its funding to the area to cover the costs expected to 2030. Increasing direct funding to the same level currently received in London (including the GLA) would generate an additional £535m per year (£8.025bn over 15 years).

14. LGF suggests that **South East local authorities could start to outline a potential solution to filling the infrastructure funding gap by mixing investment sources together.** LGF has divided the various funding sources into three groups outlined below.

- **Funding under local control or subject to some relaxation from the Government**. The ability to generate additional resources is limited. LGF estimates that, over 15 years, these sources could raise about one-third of the funding gap **(£7.1bn).** Even here, relaxation would be required from the Government on Council Tax increases. There is some scope to press the Government further on developer contributions, but the scope for doing this is limited by the viability of the underlying developments.
- **Funding available for devolution deals and elected mayors**. LGF suggests a devolution deal could give the South East access to additional funding through an Infrastructure Fund and a business rate supplement. These could raise an estimated **£6.2bn** over 15 years. Some direct funding from the Government is implicit in the Infrastructure Fund.
- **Funding with major fiscal impacts for the** Treasury. LGF believes that only by allowing the South East to retain a wider range of locally collected or generated taxes could the area find the resources to close the infrastructure funding gap fully. In return, the South East would need to offer significant investment and (guaranteed) economic benefits. Changes in how these taxation streams are allocated would have very significant fiscal impacts on the Treasury or on other local authorities elsewhere in the country if the South East retained a larger share of its tax base growth.

15. **The offer to the Government does not have to be an all or nothing offer** for the tax streams mentioned above. For instance, **options might be to ask the Government to**:-

- **protect 25% of the Council Tax base growth for local use, or growth in tax base above a certain benchmark** (for example 1.5%); or
- **reserve 10% of total business rate income for investment in infrastructure**.

16. This approach is more attractive than just asking for money from the Government. It blends retaining growth, using the tools that are available (such as increasing rates) and investing to deliver. Local authorities could also make clear to the Government that the additional retained funds would be invested in a long-term infrastructure plan with fiscal benefits to the Exchequer by increasing corporation tax, income tax and national insurance contributions.

17. All the options involve councils taking some additional risk. Some could be categorised as low risk (council tax precept, business rate supplement). But others – particularly any taxation growth – involve additional risk. There will also be risks on the spending and investment side, and the sums will potentially be significant.

Removing restrictions to free-up more infrastructure investment

18. Affordability is the main restriction on the amount of infrastructure that can be funded locally. There is very little resource in most local budgets to support prudential borrowing. Local authorities need to have a reasonable expectation that there will be sufficient future revenues to cover repayment and interest charges to make infrastructure borrowing affordable.

19. The ability to invest locally in infrastructure is hampered because a relatively small share of locally-collected taxation is retained locally. The links between population, economic and tax base growth need to be more strongly recognised.

20. LGF identifies **14 ideas that local authorities could consider as individual or collective elements in a discussion with the Government about removing restrictions to achieve greater investment in infrastructure**. These are listed below.

a) Exploring the retention of some taxation streams, with particular focus on a share in the growth of **Stamp Duty Land Tax**.

b) Maximising the amount of **business rate growth retained locally**, with a lower levy, and minimising the risk dealt with locally (mostly appeals). Clearer rules for resetting baselines (including timing and a clearer methodology) could establish what would be retained locally.

c) Exploring potential for the South East to **retain an element of the current central share of business rates**. A costed investment plan could be used to justify the investment, and the share would be led by the investment requirements.

d) Developing **Tax Increment Financing** more widely across the South East so that growth is retained and protected more effectively.

e) Exploring the potential to retain some or all of the **growth in the tax base** and to reduce the effects of equalisation through the funding regime. This would give greater certainty about the proportion that can be kept locally over a period of years.

f) Retaining **New Homes Bonus**, or similar, in the long-term so there is a continued incentive to build housing and provide funding to invest in the infrastructure required for housing growth.

g) Introducing a **business rate supplement** with an increase of up to 2p on the national multiplier. LGF suggests exploring whether the supplement could be used across the whole South East without an elected mayor.

h) Seeking an **infrastructure precept on Council Tax** of up to 1% to fund investment. This would be in addition to the 2% referendum threshold and 2% social care precept.

i) Seeking powers to maximise the funds that can be raised from **Section 106 and CIL** so that a greater proportion of the infrastructure “burden” can be funded by developers (who will receive the financial benefits from the developments).

j) Exploring potential to keep a larger share of the **locally raised taxation for infrastructure**. Specific amounts, targets and outcomes could be agreed with central government. LGF thinks a case could be made in terms of the wider economic benefit to the UK and Treasury.

k) Getting greater **clarity about how “fiscal neutrality”** is being defined by the Government and the deals that would be acceptable in return for greater tax retention.

l) **Reviewing the allocation process** whereby a large proportion of direct grant funding goes to London, to recognise the infrastructure needs of the South East.

m) Discussing with the Government an **Infrastructure Fund** that is commensurate with the arrangements in existing devolution deals.

n) Understanding from the Government that **local authorities are taking on more risk**, which means that funding regimes need to be designed to support this change in role.

Annex: Summary of types of infrastructure included in LGF costings

- Transport (motorways, highways, rail, buses/public transport and walking/cycling/other transport).
- Education (early years and childcare, primary and secondary education, post-16 and adult education).
- Health and social care (primary care, acute hospitals and mental health, and adult social care).
- Community (libraries, youth services, community and indoor sports facilities, outdoor sports and recreation).
- Green infrastructure (parks, open spaces and countryside).
- Utilities (energy, broadband, water and waste water, and waste).
- Flood protection (flooding, coastal and reducing flood risk to homes, businesses and infrastructure).
- Emergency services (blue-light emergency services).
- Housing (volume, type and location).
- Business infrastructure (office accommodation, supplier infrastructure and retail space).