City Region Deal Growth Incentive proposal

Purpose

1. To provide members with the detailed proposals for the Growth Incentive City Region Deal, in advance of a report to the four West of England Councils.

Background

2. On 5th July the West of England agreed the principles of a City Region Deal with Government as part of a national announcement of City Deals. The West of England deal is made up of six elements:
   a) Growth Incentive proposition
   b) Transport Devolution agreement
   c) City Growth Hub
   d) Skills programme
   e) Bristol Public Property Board (Bristol-only deal)
   f) Low carbon infrastructure (Bristol-only deal)

3. In July 2012 it was made clear that the Growth Incentive proposal would be subject to future formal Council approval. It was agreed that this element, if confirmed, would come into effect from April 2014. Approval by the four Unitary Authorities to the formal adoption of the Growth Incentive proposals will be sought during full Council meetings in July.

Growth Incentive proposal - summary

4. The Growth Incentive proposal is an agreement between Government, the West of England unitary authorities and the West of England Local Enterprise Partnership giving increased local financial flexibility and freedoms in exchange for a focussed programme of investment to enable the region to achieve its full economic growth potential.

5. The Growth Incentive deal provides a licensed exemption from the effects of the resets and levies of the local government finance system in five enterprise areas over 25 years, enabling the West of England (WoE) to retain 100% of growth in business rates against an agreed baseline in the EAs (and EZ). The five West of England Enterprise Areas are:
   - Avonmouth/Severnside
   - Bath City of Ideas
   - Junction 21
   - Filton
   - Emersons Green
National Local Government Finance System

6. The Growth Incentive proposal agrees certain licensed exemptions from the current local government finance system. The current local government finance system was launched on 1st April 2013 which introduced the Business Rates Retention Scheme (BRRS) as one of the primary forms of local government funding.

7. The government has set the baseline level of business rates it expects each council to be able to generate in each year. If a council fails to deliver business rates to this base line it has to meet the shortfall from alternative council resources up to a ‘safety net’ figure, after this, the shortfall is met by national funds from a national safety net. It is important to note that this national safety net is funded by local government through the BRRS via the payment of a ‘levy’ by some councils.

8. If a council exceeds its baseline in any one year, it is able to keep a share of that ‘growth’ locally. The growth is shared 49% (local authority) 1% (Fire authority) 50% (Central Government). Where that growth is deemed to be disproportionately large in the context of the council’s base budget, the local authority has to pay a further ‘levy’ on its share of the growth. As set out above, this levy is then pooled at a national level and will be held to fund any calls on the national safety net.

9. In addition to this, any growth in business rates is only maintained until the next reset period. At which time the national system is ‘reset’ and the process begins again. Exactly how this reset will work is currently unclear, however it is expected the first reset will happen in 2020 (7 years) and thereafter every 10 years, although this is not guaranteed.

Growth Incentive proposal – how the scheme would work

10. The Growth Incentive deal provides a licensed exemption from the effects of the resets and levies of the local government finance system in five enterprise areas over 25 years, enabling the West of England (WoE) to retain 100% of growth in business rates against an agreed baseline in the EAs (and EZ).

11. The local authorities will pool the business rate growth from the Enterprise Areas with that from the existing Temple Quarter Enterprise Zone. The pool will make a significant financial contribution (up to £500m over 25 years) into a West of England Economic Development Fund (EDF) which will support an overall package of £1bn of investment in the local economy. Income will also be used to ensure no local authority will be worse off compared to the local government finance system, and to manage local demographic and service pressures arising from growth. A diagram depicting this is shown in appendix 1.

12. The West of England Local Enterprise Partnership will facilitate the delivery of a programme of investment from the Economic Development Fund (EDF) to unlock and accelerate economic growth in the West of England. The EDF will
comprise the business rate growth revenues, which will be used in conjunction with other Government funding streams to deliver an investment programme focussed around the Enterprise Zone and five Enterprise Areas.

**Business rates pooling arrangements**

13. The pooling arrangements for the Enterprise Areas will be in place for 25 years with effect from 1st April 2014 to the 31st March 2038. Primary legislation will be laid in the Autumn of 2013 to enable the councils to retain 100% of the business rates growth from the Enterprise Areas. As the Enterprise Zone started in April 2013, a year earlier than the Enterprise Areas, the income from this year will be held and paid into the pool on its commencement. As the 25 year period of Enterprise Zone rate retention starts a year earlier than the Enterprise Areas, it will also end one year earlier than the Enterprise Areas.

14. All business rates growth above an agreed baseline, across the Enterprise Zone/Areas will be pooled in one business rates pool. The LEP Board will agree to the Enterprise Zone growth being pooled within the business rates pool, in return for an overall contribution of up to £500m from the pool to the EDF over 25 years.

15. It is important to note that in respect of the Enterprise Areas, the exact boundaries for Growth Incentive purposes will differ slightly. Fiscal boundaries (Growth Incentive Areas) within the Enterprise Areas have been created which will be used for the purposes of business rate pooling arrangements. These are shown in Appendix 2. The boundary for the Enterprise Zone has already been set as part of its formation in April 2013 and cannot be amended as it is already set in primary legislation. Fiscal boundaries have been created as the Enterprise Areas already have businesses within them paying business rates. If a current business is included within the growth incentive proposals then its current level of business rates will form a baseline. It is only when this figure is met (i.e. only growth above this level after an annual inflationary uplift) that the growth incentive proposals come into effect. The expected baselines for each Area and Zone are set out in the table below:

<table>
<thead>
<tr>
<th>Enterprise Area</th>
<th>Net Charge on 14 September 2012 (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>J21</td>
<td>191,247</td>
</tr>
<tr>
<td>Bath City of Ideas</td>
<td>4,703,086</td>
</tr>
<tr>
<td>Filton</td>
<td>430,952</td>
</tr>
<tr>
<td>Emerson’s Green</td>
<td>0</td>
</tr>
<tr>
<td>Severnside</td>
<td>185,660</td>
</tr>
<tr>
<td>Avonmouth</td>
<td>6,245,175</td>
</tr>
<tr>
<td><strong>Total EA</strong></td>
<td><strong>11,756,120</strong></td>
</tr>
<tr>
<td>Temple Quarter*</td>
<td>12,413,482</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>24,196,602</strong></td>
</tr>
</tbody>
</table>

*based on 31st December 2011*
16. The local authorities will not be paying a Levy on any growth in the Growth Incentive Area (GIA). Under the local government finance system this Levy funds the national safety net. In this respect the GIA will not have access to the national safety net. This should not pose a significant risk to the pool so long as each UA is underwriting their respective baselines, and the pool only commits funding on an annual basis in line with its expected cash flow projections. The main risk to the pool in this circumstance will come from rating appeals lodged with the valuation office, especially those that are backdated in nature, which will need to be mitigated by the holding of a contingency (appeals relating to baseline properties will remain the responsibility of the respective local authority).

17. The use of the pooled business rates will be determined on the basis of 3 ‘tiers’ of activity over the 25 year period. The financial value of each will be dependent on the level of business rates growth actually generated. The pool will be operated in such a way as to ensure that any financial risk to the authorities is mitigated as far as is possible.

18. **Tier 1 Payment** – ‘no worse off’ payment. As set out above, under the local government finance system each Unitary Authority would get to retain locally 49% of any business rate growth above the baseline, less any applicable Levy. The first call on the pool will therefore be to ‘repay’ each local authority what it would have received under the local government finance system. In this respect no local authority should be ‘worse off’ as a result of signing up to the Growth Incentive Deal. In respect of Bristol City Council, it will receive a tier 1 payment for the Enterprise Zone as if it had been a normal part of the local government finance system rather than operating under Enterprise Zone legislation, reducing the amount that would otherwise be available for Tier 2 and Tier 3 contributions. Tier 1 will also include the setting aside of costs associated with the operation of the pool, and creating a contingency (equivalent to the national safety net) for meeting issues such as bad debts and revaluation appeals.

19. **Tier 2 Payment** – This will be the contribution from the pool to the EDF. This will be up to a maximum amount of £500m over 25 years. This payment will
only be made available to the LEP (EDF) if it is financially sustainable to do so (to the pool) having met Tier 1 costs and in proportion to the Tier 3 payments. The cash would need to be generated before payments would be made, leaving minimal in year risk which would need to be accounted for as part of the tier 1 contingency sum. The costs associated with the programme management of the EDF and the development of scheme business cases through to delivery will be met by tier 2 (EDF) if supported by the LEP.

20. **Tier 3 Payment** – This will be a payment to each Unitary Authority to mitigate local demographic and service pressures arising from the additional growth. It is therefore important this payment grows in proportion to the level of growth being generated and a ratio of 5:1 has been assumed (for every £5 Tier 2 payment there will be a £1 Tier 3 payment). To support cash flow in the early years and prioritise investment in unlocking the growth sites earlier, it is proposed the Tier 3 payment will not be paid in the first 5 years of the deal. It will start in year 6 with the equivalent amounts due from years 1 to 5 being recovered over the following 5 years on top of the normal payments. Flexibility will be maintained by the pool to determine whether Tier 3 payments should begin earlier than year 5 once the detailed schemes and requirements of the EDF are more fully known. Once the full Tier 2 payment has been made (£500m) any surplus sums over and above this will become a 100% Tier 3 payment to further mitigate the impact of growth.

21. The Tier 3 payment to each of the 4 Unitary Authorities will be split on the basis of a formula. 50% will be allocated to each council on the basis of what proportion of growth each Enterprise Area/Zone has contributed to the pool in each year (after Tier 1 payments). 50% will be allocated on the basis of housing growth seen in each whole council area on an annual basis. This latter element is to provide support to those areas which may be providing the housing related to the additional growth, but not necessarily the increase in business growth itself.

22. As the business rates pool is a local government funding stream, full accountability and discretion around decisions in relation to the pool will rest with the Unitary Authorities only. South Gloucestershire Council will be the accountable body for the pool. A Business Rates Pool Board will be created made up of the 4 council Section 151 officers (or substitutes), with an invitee representing the LEP and the Environment Directors. This will be a technical Board to monitor and administer the pool. It will operate within the parameters agreed by Members as set out above. Any changes to the policy in which the Board operates will require member approval by the 4 councils. Regular reports on the operation, monitoring and performance of the pool will be made to each Council and the LEP Board.

**Economic Development Modelling**

23. To provide an exemplification of the potential growth from each Enterprise Area/Zone that could be generated over the next 25 years, an external specialist company (Amion) was commissioned. As has been demonstrated above, broadly speaking any growth across the area should prove beneficial to
the West of England under the Growth Incentive proposals as it will retain within
the West of England an element that would otherwise be lost nationally.

24. Amion consulting worked with officers from each council, talked with
businesses and land owners, used past experience locally as well as national
guidance, and tested their assumptions against an independent property
specialist and specialist chartered surveyors. This has led to a series of
assumptions and projections for each Enterprise Area and Zone. Clearly trying
to project forward the economy over 25 years is inherently difficult, in both
totality and phasing terms. Therefore a base scenario, a pessimistic scenario,
and an optimistic scenario were created, with relative probabilities attached.

25. The model shows that over the next 25 years the potential growth resulting from
the GIA is £842m (baseline scenario), with a pessimistic assessment of £653m,
and an optimistic assessment of £957m. To allow for risk, the ‘weighted
average’ of these scenarios (£811m) has been taken into the financial
modelling assessment.

26. It is important to note that this is only one exemplification, and shows an
indication of the potential growth achievable. This is broken down further by
Enterprise Area and Zone below.

27. This reference case assumes no impact from additional investment resulting
from the £500m EDF contribution to the LEP. The LEP will need to focus its
investment in the Enterprise Areas and Zone in order to achieve the maximum
£500m contribution to the EDF.

28. Intervention models can then be created in the future as part of determining the
impact of different investment decisions resulting from the £500m EDF on this
reference model. Therefore as set out above, investment from the £500m EDF
(assuming it relates to the EAs/EZ) should only further enhance the level of
growth resulting from the Growth Incentive proposals, having a positive impact on the cash-flows into the business rates pool.

29. In addition to the retained business rates benefit, the modelling shows additional benefits in terms of GVA uplift, and jobs creation over the 25 years as shown in the charts below. Again, with additional investment from the EDF, this will further increase the level of GVA and jobs.

**Economic Development Fund**

30. Payments will be made into the EDF on the Tier 2 pooling basis set out above. This means the EDF will only receive funds on the basis of cash actually being generated into the pool. On this basis the cash flows will be small in the early years. BANES will be the accountable body for the EDF in line with its current responsibilities around support to the LEP and WoE Office.
31. The LEP Board (comprising the 4 Local Authorities and 4 business representatives) will need to set the priorities against which the EDF will be spent in promoting and accelerating economic growth. It is expected the governance for this will be similar to that currently in place for the Revolving Infrastructure Fund, as outlined in Appendix 3.

32. The EDF will only be able to commit on an annual basis up to the sums it receives from the pool. On this basis should the LEP Board decide it wants to pump prime schemes in advance of cash flows being generated (e.g. through borrowing), this would require the approval of the sponsoring local authority, who would also be required to undertake (and therefore underwrite) that borrowing. This will need to be determined by each local authority at the time of approving each scheme, following a full business case and risk assessment on a case by case basis. The financing costs of any borrowing would also need to be borne by the EDF.

33. The LEP and Local Authorities have initiated a piece of work identifying those schemes that could be critical to the unlocking or accelerating of growth across Enterprise Areas, or would be priority schemes in the promotion of the GIA. Subject to more detailed business cases being required for many of these, they should form the first phase(s) of work funded by the EDF.

**Legal Implications**

34. The statutory basis for the Local Retention of Business Rates Scheme is the Local Government Finance Act 2012.

35. The Government’s exemption for the West of England’s City Region Deal Agreement will apply for 25 years from its effective date of 1\textsuperscript{st} April 2014, and will be laid in primary legislation.

36. In order to implement the Growth Incentive proposals and benefit from the freedoms and flexibilities that the scheme is intended to deliver, each UA will ‘voluntarily’ enter into binding agreements (4 party - between the 4UAs and 5 party – between the 4UAs & Local Enterprise Partnership) These Agreements will address the detailed pooling/accounting arrangements for the business rate growth across the West of England as well as risk, governance, review, liabilities and indemnities and procedures for determining investment and spending priorities.

37. These Agreements will have a maximum term of 25 years to reflect the Government’s licence exemption period but will be terminable earlier subject to agreed provisions in the Agreements.

38. Lawyers for the 4 UAs are working to develop the detail of these Agreements to ensure that they are robust and that they comprehensively operate in the best interests of each UA whilst fully utilising the principles of the Scheme to the benefit of the West of England.
39. In addition to these Agreements, the West of England is required to provide the Government with a written assurance (a letter of comfort) concerning the operational arrangements that have been agreed by the 4 UAs and LEP under the Growth Incentive proposals.

Equality and Sustainability Implications

40. There are no direct equalities impact issues arising directly from this report.

41. The Councils will be facing significant additional economic and service pressures over the next 25 years. The additional funding that these proposals generate could help to alleviate some of those pressures, through both the provision of critical local infrastructure to support the economy, and through Tier 3 payments in respect of mitigating service and demographic pressures.

Other Risk Implications

42. A key risk is that the business rates growth does not materialise as projected. This is highly likely given the difficulties of trying to project forward the economy and its impact on a specific area for the next 25 years. Should this level of growth not materialise then this would lead to less funding being available to the pool, resulting in lower Tier 2 and Tier 3 payments. Potentially leading to a lower overall payment to the EDF. So long as the pool does not pre-commit future funding streams the financial risk to the local authorities and the pool of this is minimal.

43. This risk will differ across the EA and EZ locations. Some do not currently have approved comprehensive planning concept statements, whilst others have elements subject to approved development guidelines and/or planning consents. This risk will need to be monitored and managed as sites become more certain, and the projections changed accordingly.

44. The operation of the pool will include the creation of a contingency which will need to grow over time and remain proportionate to the size of the financial risk faced. The projections included within this report are based on a weighted average likelihood of economic growth occurring, and have then been further reduced to account for bad debts and a general contingency.

45. A further risk comes as a result of changes that may happen over the next 25 years at a national level which could impact on the proposals. Examples of this might include a future government stopping or amending the scheme through primary legislation, or changes to the local government finance business rate system which then impacts on the projected level of income.

46. Once again these risks can be mitigated by ensuring the pool does not pre-commit future cash flows. The proposals are laid in primary legislation, and the new burdens principle could apply where relevant. Should the scheme be ended early, then the West of England would have gained the additional benefit for as long as the proposals had been in operation. Should the local government financing scheme be changed in such away as to make it more
beneficial nationally to local authorities then this would need to be accounted for locally as part of the Tier 1 payment structure.

47. As discussed earlier in the report there could be a risk to local authorities who have borrowed via the EDF based on expected future income streams. This will need to be considered on a case by case basis when the local authority comes to support decisions around specific infrastructure/investments. Mitigating actions to this were outlined earlier in the report.

48. The letter of comfort between the West of England and the Government will also seek, in so far as is possible, to mitigate any unforeseen risks that could occur when the local government finance system is reset (currently expected in 2020 and thereafter every 10 years).

49. The highest risk to cash flow will be in the early years of the scheme, although this should be mitigated through each UA underwriting its base line position to the pool, and the setting aside of a contingency for new growth. Expectations will need to be managed locally in the early days as to the level and availability of funding.

50. Audit of the pool will form part of the normal internal and external audit arrangements of the accountable body, and will be reported independently to each council’s Section 151 officer.

Recommendation

51. The Joint Scrutiny Committee gives views on the Growth Incentive proposal, prior to making a recommendation to Councils.

Author

Dave Perry, Deputy Chief Executive & Director of Corporate Resources, South Gloucestershire Council
Appendix 1 – Economic Development programme

£500m pooled Business Rates contribution

£1bn Economic Development programme

Interventions to maximise economic returns throughout WoE through City Deal package

<table>
<thead>
<tr>
<th>Skills</th>
<th>Innovation</th>
<th>Enterprise</th>
<th>Inward Investment</th>
<th>Infrastructure</th>
</tr>
</thead>
</table>

Projects to unlock / further economic development

- Flagship Projects
- Sites throughout WoE
- Enterprise Areas

£138m critical infrastructure to unlock sites
Appendix 3 – Proposed EDF governance

- LEP Board
- Investment Award Panel S151 Officer
- Officer Review and Due Diligence
- Project Proposal and Business Cases from Unitary Authorities