Financing for Growth:

A new model to unlock infrastructure investment

Dan Gregory with Howard Dawber

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Foreword

The levels of investment in infrastructure in the UK are woefully low. Whilst public finances are under pressure in the current climate, it is important to realise that our current predicament with infrastructure finance is not a result of present austerity measures; it is an ongoing failure of investment and imagination. For all the talk of financial innovation during the boom years of New Labour , the only investment model that we had for public infra-structure and that went to scale was PFI and that has proved an expensive and ongoing folly.

It is increasingly clear that we need a new approach and new model for infrastructure finance. This need for a new investment vehicle is now almost universally acknowledged – yet by the same token no new financial institution that could re-align public needs, private demands and civic interests around a new model of infrastructure investment has emerged. Given the state of public sector finance and the history of how the public sector has been gamed and sold short, we have to find a new mechanism for sharing public sector risk as well as private sector reward.

The central proposal of this report promises a break with the impasse of the last few decades. By capturing and creating a new ethos and capitalising on the long term commitment of the stakeholders involved, our proposed "Community Infrastructure Bond" can deliver not just a quick injection of funding for infrastructure development, but the will and the wherefore to make it all happen. It promises reliable returns and escapes the trap of short-termism, and creates a valuable opportunity for citizens and communities to engage more directly and meaningfully in the financing of infrastructure development.

We desperately need a sustainable model for financing UK infrastructure. We need a new paradigm that transcends the destructive antagonism between the public and the private sector. This report proposes such a paradigm shift, both from the perspective of our localities and from the standpoint of wholesale capital. We hope and believe that this new bond structure can go to scale and reward all parties who participate in it with the cities, towns and neighbourhoods we all need and want to live in.

Phillip Blond
Director, ResPublica

Executive Summary

The Government is rightly concerned about Britain's infrastructure crisis. Between 2000 and 2007, the UK was the lowest investor in infrastructure of all the OECD countries, and the World Economic Forum has ranked the United Kingdom a lowly 32nd for "quality of overall infrastructure".[1] First quarter investment in 2012 in infrastructure, according to figures from the Office for National Statistics, was 11% lower than a year earlier while new orders for construction – a leading indicator of work – fell 14% compared with the previous quarter.[2] Clearly the infrastructure gap has yet to be filled and the main reason for this is the lack of a financial investment vehicle to draw in the required funds.

1 Datapult (2010) *Quality of overall infrastructure (WEF Global Competitiveness Report 2010-11)* [Online] Available at: http://www.datapult.info/en/content/quality-overall-infrastructure-wef-globalcompetitivenessreport-2010-11 [Accessed 21 May 2012].

2 Plimmer, G. (2012) 'Construction projects stifled by indecision', *The Financial Times*, 2 July 2012 [Online] Available at http://www.ft.com/cms/s/0/3b66699c-66c3-11e1-9d4e-00144feabdc0.html#axzz20tUnb68W [Accessed 10 July 2012]

Partly, our current predicament is because public finances are under more pressure than at any time in the living memory of most citizens. But it is also partly because we have lost faith in our investment models. The models of infrastructure financing we have developed over the last few decades are failing to do the job for which they were designed.

This report considers public, private and hybrid public/private models of finance and their respective costs, benefits and effectiveness. It provides a critique of the most popular models, those financed through public borrowing and taxation, and those which share risks through partnership between the public and private sector. PFI, for example, the vehicle which has funded much of the investment in UK public infrastructure in recent years, is now viewed as an inefficient and unpopular investment vehicle.

There are a number of pressing challenges here. We have identified a need for suitable investment terms to attract new investors, whether local or global, pension funds, wealth funds or philanthropic investors; structuring the public sector contribution in a way which shares risk, delivers value for money, and accounts for public sector liabilities transparently, but which is also attractive in terms of the public sector balance sheet; and all the while being simple and mindful of externalities and the consequences for local community engagement.

But there are also intriguing opportunities here. Recent years have witnessed the emergence of peer-to-peer and community financing models. We have a chance to open up the infrastructure investment market beyond conventional intermediaries, making links directly to communities. The value of all savings and investments - including pensions, shares and deposit savings - held by UK households has more than quadrupled (305%) in real terms over the past 50 years, increasing from £993 billion in 1959 to £4,024 billion in 2009 (in 2009 prices). So investment in local, tangible infrastructure could be a way to channel the potential of individual savings and investment, while simultaneously giving local citizens a literal stake in their community. Corporate cash levels too, are unharnessed, with UK companies currently sitting on hoards of cash worth £750 billion - larger than their US and Eurozone counterparts. Encouraging even a small proportion of this through our proposed bond will do much to revive infrastructure investment. The cash-rich corners of the voluntary sector too are increasingly looking for social investment opportunities with trusts and foundations increasingly keen to invest their reserves more imaginatively in projects which deliver social, as well as financial return.

The public sector can reconfigure its role here not as a spender but as an investor - with a longer time horizon and a wider account of the benefits it wishes to secure. The private sector should base its own investment priorities on the balance of risks minimised by a public sector partner. And investment in infrastructure should broker in local and communal interests, engaging businesses, residents and civil society.

A Community Infrastructure Bond

To address the imperatives outlined above, we present an emerging model for a "Community Infrastructure Bond" constructed and underpinned by a suite of revenue streams, not all reliant on conventional tax and spend models but also through revenue linked to land and property value.

Whilst not a panacea, at the heart of this report is the idea that in certain circumstances, such a Community Infrastructure Bond could offer an optimum combination of the various advantages of the models above, thereby promising a practical and attractive model for financing infrastructure development in the UK, particularly in the current economic climate. This option can also capture latent potential from households, private business and the community sector.

Encouragingly, the Coalition Government is currently exploring the potential of new central government-backed "Growth Bonds" to raise money directly from citizens to be invested in major infrastructure projects. The Treasury has also been looking at how the public sector might take 'first loss' on certain infrastructure investments, through recently announced "UK Guarantees". The opportunity must not be missed to construct a bond model which aligns the interests of public, private and social capital.

Revenue streams to underpin a Community Infrastructure Bond

Community Infrastructure Bonds would be issued by an independent special purpose vehicle (SPV) or "Community Infrastructure Vehicle".

These bonds would be underpinned 'underneath the bonnet' by a range of revenue streams, to deliver returns. There would be no one-size-fits-all model, with local hybridity and diversity according to the local context supporting a universally recognisable platform for investors. Possible revenues include:

- Public budgets and supplementary taxation;
- Private sector contributions and planning gain;
- Future tax revenues (such as Tax Incremental Financing);
- Land Value Capture; and
- Other revenue streams such as efficiency savings, asset transfers, statutory charges, fees and levies and community and citizens' contributions.

The attractiveness of such bonds could be enhanced through tax incentives, guarantees or a risk investment tranche in this Special Purpose Vehicle (SPV), with the benefit of de-risking the debt tranches while also reversing the problematic characteristics of the Private Finance Initiative (PFI) whereby private investors stand to earn uncapped returns on the upside.

A further benefit of this proposed model is the way in which the formation of SPVs outside the constraints of public administration can provide a focal point for self-defining communities of interest - public, private, social or individuals - to develop projects and programmes for infrastructure delivery, across rigid public sector boundaries and beyond the influence of short-term politics.

In summary, a Community Infrastructure Bond offers an intriguing opportunity for citizens and communities to engage more directly and meaningfully in the financing of infrastructure development. Such vehicles would enable an improved, more transparent, diverse and democratic control and governance.

The report concludes by suggesting concrete steps to be taken by central, local Government and others to support the renewal of infrastructure development across the UK over the coming years. HM Treasury, the Department of Communities and Local Government, the Local Government Association, the Core Cities group, local authorities, LEPs and social and community finance experts should work together to explore how a combination of fiscal incentives, public guarantees, land value capture, supplementary taxation, planning gain and Tax Incremental Financing could underpin community infrastructure bonds to ignite more sustainable model for financing UK infrastructure.

1 Introduction

Infrastructure provides the foundations on which the UK economy is built. Encompassing long-term fixed capital assets that enable and support economic activity in fields such as energy, transport, water, waste and communications, infrastructure has undeniable importance in driving growth, output and economic and social capital.

In terms of economic benefit, its significance is perhaps unrivalled. As the Core Cities Group argue, "[i]nfrastructure brings greater economic returns on investment than many other forms of capital expenditure, producing £10 of benefit for every £1 spent."[3] Investment in infrastructure is well recognised in having a lasting impact on the long-term prospects for the economy: rail infrastructure built in the 1950s is still in operation today and bridges and tunnels across the Thames still serve us over 150 years after they were built.

Yet capital investment in infrastructure in the UK is decreasing, or stagnating at best. The OECD figures suggest we have a national infrastructure deficit, widely touted as £500 billion over the next decade. The World Economic Forum has ranked the United Kingdom a lowly 32nd for "quality of overall infrastructure", sandwiched between El Salvador and Estonia.[4] Between 2000 and 2007, the UK was the lowest investor in infrastructure of all the OECD countries, and High Speed 1 was the first new mainline railway for 100 years. So the need to invest anew in our infrastructure development is almost undisputed. Dieter Helm argues that "[i]nfrastructure investment would not only stimulate the economy, but would also address its chronic productivity and competitive problems"[5]. As the Government so clearly puts it, "Britain will not be able to compete in the modern world unless we improve our infrastructure."[6]

Since the failure to deliver growth is now impacting on the deficit reduction strategy, the Chancellor George Osborne has repeatedly vowed to put infrastructure investment at the heart of the Government's economic recovery efforts. Plans announced with much fanfare in November 2011 for pension funds to resource £20bn of investment in new build infrastructure projects have not so far materialised. As only 10% of the envisaged 20 billion appears to have been raised so far and work will only start in 2013/14 at the earliest, this is not likely to make a great impact on growth and deficit reduction in the short-term. Moreover, the latest news from the infrastructure sector itself is worrying. First quarter investment in 2012 in infrastructure, according to figures from the Office for National Statistics, was 11 per cent lower than a year earlier while new orders for construction – a leading indicator of work – fell 14 per cent compared with the previous quarter.[7] Clearly the infrastructure gap has yet to be filled and a principal reason for this is the lack of a financial investment vehicle to draw in the required funds.

3 Core Cities Group and the British Property Federation (2010) *A rough guide to tax increment financing* [Online] Available at: http://www.bpf.org.uk/en/files/bpf_documents/A_Rough_Guide_to_Tax_Increment_Financing.pdf [Accessed 21 February 2012].

4 Datapult (2010) *Quality of overall infrastructure (WEF GlobalCompetitiveness Report 2010-11)* [Online] Available at: http://www.datapult.info/en/content/quality-overall-infrastructure-wef-globalcompetitivenessreport-2010-11 [Accessed 21 May 2012].

5 Helm, D. (2009) *Britain must save and rebuild to prosper* [Online] Available at: http://www.dieterhelm.co.uk/node/776 [Accessed 15 February 2012].

6 HM Treasury (2011) *National Infrastructure Plan* [Online] Available at: http://cdn.hm-treasury.gov.uk/national_infrastructure_plan291111.pdf [Accessed 20 June 2012].

7 Plimmer, G. (2012) 'Construction projects stifled by indecision', *The Financial Times*, 2 July 2012 [Online] Available at http://www.ft.com/cms/s/0/3b66699c-66c3-11e1-9d4e-00144feabdc0.html#axzz20tUnb68W [Accessed 10 July 2012]

Partly, our current predicament is because public finances are under more pressure than at any time in the living memory of most citizens. But it is also partly because we have lost faith in our investment models. The models of infrastructure financing[8] we have developed over the last few decades are failing to do the job for which they were designed.

Also in November 2011, the Chancellor announced he wanted to reform the much-maligned Private Finance Initiative (PFI) model admitting that it can be "too costly, inflexible and opaque".[9] Concerns about PFI range from initial and on-going overcharging of the state, to undue profit-taking through private sector refinancing. However there is no other 'at scale' platform for driving forward the required investment in public infrastructure – PFI is therefore in the paradoxical position of being run out of a town in which it is the only game. The Treasury is looking for ideas for "a new approach" which needs to deliver lower costs and better value for money, make more effective use of private sector innovation and skills, improve flexibility and transparency, create the right incentives to manage risk and ensure that projects are completed to deadlines and budget.

Meanwhile, investment is pouring into London from around the world, identifying a safe and lucrative haven in British property on the basis of high expectations of both future capital growth and income, our relatively stable legal system and a liquid market. Yet this opportunity is going to waste as we lack the appropriate vehicles to channel this investment towards the enhancement and development of assets which both service communities and support the economy. Our creaking old models soldier on. Most projects remain publicly financed. The use of PFI is still widespread. Planning gain (through the old Section 106 or the emerging Community Infrastructure Levy) still provides the main basis for generating income from property development to finance many of our public and community assets.

At first glance this is a failure of the imagination. Perhaps more significantly, we are failing to focus on the traditional method of policy delivery and implementation on the ground. A plethora of ideas and models have been proposed as the way forward for financing development – but the real challenge now is how we turn these ideas into practical and attractive models. Bonds have been talked about in this context for some time and reports have speculated that the Chancellor is exploring the idea of "Growth Bonds".[10] Whilst there is clearly a need for improved models of infrastructure financing which are not only theoretically attractive but practically useful, our focus must be on implementation.

8 For clarity, we make a distinction here between two features of infrastructure development models. On one hand, how infrastructure is funded and financed; the flows of capital and revenue which enable development to proceed, where the money comes from and on what terms it is provided. On the other, the technical delivery arrangements; how the balance of delivery risk is apportioned between delivery partners, for instance through the timing and terms of payments. This report is principally concerned with the former.

9 HM Treasury (2011) *Reform of the Private Finance Initiative* [Online] Available at: www.hm-treasury.gov.uk/d/condoc_pfi_call_for_evidence. [Accessed 22 May 2012].

10 Pickard, J. and Kuchler, H. (2012) 'Idea of growth bonds floated to fund housing', *The Financial Times,* 12 June 2012 [Online] Available at: http://www.ft.com/cms/s/0/0016cefc-afb8-11e1-b737-00144feabdc0.html [Accessed 18 June 2012].

There are a number of pressing challenges here. We have identified a need for:

- Suitable **investment terms** to attract new investors, be they local, national or global, pension funds, 'sovereign wealth funds', domestic or overseas investors;
- Forms of structuring the **public sector contribution** in a way which shares risk appropriately, delivers value for money, and accounts for public sector liabilities transparently, but which remains as attractive as existing models in terms of public sector balance sheets[11];
- The establishment of **consistent and simple models** which are widely transferable and minimise transaction costs; and
- Alignment of incentives between partners whilst remaining mindful of the unintended consequences and **externalities of models** in terms of their impact on the environment, for example, and their role in re-engaging individuals and communities with the capital and infrastructure around them.

So while the importance of infrastructure to the country and the need to reawaken development is widely accepted, perspectives on how this infrastructure should be financed are far more divergent and conflicting. If we are to further investment over the coming years, clarity of purpose and action is essential.

Meanwhile, against the background of continuing private affluence and stalling public improvements, a spectre of social impoverishment haunts the UK. Circle Healthcare Chief Executive, Ali Parsa, offers a remarkable insight into models of ownership in the UK, pointing out that just "two single square miles – the City and Whitehall – control over 90% of our productive assets."[12]

While recent years have witnessed the emergence of peer-to-peer and community financing models such as Abundance, SpaceHive, Allia, Funding Circle and others, little of our infrastructure is owned locally or directly by citizens or communities. Instead, ownership is removed from communities by large layers of intermediaries that have increasingly become abstracted and anonymous bodies. Opening up this market is crucial to economic and social growth, but we are currently failing to invest in projects using the structures and models that would unleash this potential.

11 Although as Ian Mulheirn, Director of the Social Market Foundation, puts it: "That successive governments feel the need to invent complicated private finance wheezes to get round their own fiscal rules only serves to underline the absurd incentives created by the way that investment spending is treated in the National Accounts."

12 Parsa, A. (2012) 'The NHS is a professional service ripe for re-engineering', *The Guardian* [Online] Available at: http://www.guardian.co.uk/commentisfree/2012/feb/08/nhs-professional-service-ripe-reengineering [Accessed 15 June 2012].

2 Current mechanisms for infrastructure finance

The financing of infrastructure development is understandably dominated by the public sector, either alone or in combination with private partners. This chapter briefly explores the merits and limitations of the most popular models, those financed through public borrowing and taxation, and those which share risks through partnership between the public and private sector, including the Private Finance Initiative. Understanding the respective disadvantages or weaknesses of these models can lead us towards an emerging alternative model, constructed around the interests of the community our infrastructure is intended to serve.

2.1 Public Finance

The vast majority of capital spending in the UK still follows a conventional 'borrow and tax and spend' model (although not necessarily in that order) and is likely to continue to do so for the foreseeable future. Public bodies, either centrally or locally, finance the costs of development through annual budgets, or via increased borrowing, if up front capital is required. (Delivery is often outsourced to private partners through commissioning and procurement or so-called "Government Owned Contract Operated models".)

The single biggest advantage of this conventional model is the simplicity and terms of investment. Both HM Treasury and Local Government can borrow at arguably unrivalled rates, making financing cheap, routes to market straightforward and keeping transaction costs low through the well-established borrowing mechanisms of the Treasury's Debt Management Office and Public Works Loan Board (PWLB).

Yet Government borrowing is at record levels. Local government borrowing increased from by 21% between 2005-06 and the end of 2010-11.[13] As a result the Treasury is looking for ways to attract new finance; the public purse is not going to bring about the transformative change in infrastructure development that most suggest is necessary to kick-start growth. Furthermore, 100% of the financing risk under this model remains with the public sector. The challenge is to attract other sources of funding and finance.

Finally, reliance on this model brings with it the danger that investment in infrastructure is seen as something that only the (big) state does, encouraging dependency. Of course the public sector will remain a crucial player but for many projects, it is simply wasteful and unnecessary to assume that the state should pick up 100% of the bill when the benefits of development also accrue to a number of other partners.

Even though a large number of property owners in or around publicly financed developments see the value of their land and buildings rise significantly, this is rarely harnessed. In the above case study, only Canary Wharf Group and British Gas (in respect of their land on the Greenwich Peninsula) made a contribution towards the costs of the new line. Don Riley, a property owner with buildings near one of the new stations, was even moved to write a book titled Taken for a Ride, about how unfair it was that he was not asked to contribute to the project.[14]

New models of public finance have been proposed and are indeed emerging. Proposals for an infrastructure bank have been put forward, inspired by examples elsewhere, such as the German KfW, which grew out of the post-war Marshall Plan project. The nascent Green Investment Bank is perhaps the nearest thing we have to the realisation of these ideas, or perhaps the Treasury's Infrastructure Financing Unit which was created in the wake of the credit crisis of 2008 to reactivate the lending market for government PFI projects. The Treasury recently announced a new temporary lending programme to ensure that around 30 infrastructure projects worth up to £6 billion can progress over the next year.

13 Department for Communities and Local Government (2011) *Statistical release: Local authority borrowing and investments – 2010-11* [Online] Available at: www.communities.gov.uk/documents/statistics/pdf/2041385.pdf [Accessed 19 June 2012].

14 *Riley, D. (2001) Taken for a Ride: Trains, Taxpayers and the Treasury, London: Centre for Land Policy Studies*

CASE STUDY

Transport for Canary Wharf

When the Canary Wharf project started construction in 1987 the main transport routes to the Isle of Dogs consisted of a narrow street along the riverside and the unfinished first phase of the Docklands Light Railway (DLR). This was insufficient support for the regeneration of an industrial wasteland into a major new business district. Understanding that better public transport connections would dramatically improve the accessibility and therefore value of their development, the developers campaigned for additional rail and road links. However, this was negotiated on an ad-hoc basis for each piece of infrastructure rather than using a mechanism which truly linked rising property value to the costs of the transport projects.

The DLR extension to Bank which opened in 1991 was partly funded by a £70m contribution from the Canary Wharf developers as a direct payment towards the project. Canary Wharf also paid £50m for the Canary Wharf Station and delivered a second station on a shared cost basis. With DLR in operation employment in the Canary Wharf area rose to 25,000 by the end of the 1990s. Without the DLR it is likely that the early stages of the development would not have been possible.

The second big piece of transport infrastructure, the Jubilee Line Extension which opened in 1999, was partly funded by a £400m contribution from Canary Wharf Group, with a contract in place under which the money would be paid when the line reached full operation. This service level has only recently been achieved, 13 years late, following a signalling upgrade of the line. With the upgraded Jubilee line, Canary Wharf's employment numbers reached 100,000 by mid 2012.

The Department for Communities and Local Government's Growing Places fund, worth £500m, goes some way towards an alternative model of publicly-led financing. This model holds intriguing potential in that it serves to localise, or at least regionalise public investment, and could lead to the creation of a number of sustainable and independent, regional development finance institutions. This fund, however, will only take us so far.

2.2 Public Private Partnerships

The last few decades has seen over 900 infrastructure projects delivered through Public Private Partnerships (PPP) worth more than £70 billion.[15] PPPs are development ventures financed and managed through a partnership between one or more public bodies and private sector partners, whereby financial terms and risks are shared to some extent under a commercial agreement.

15 PLC Public Sector (2011) *New models for PPP? The prospects for the PFI review* [Online] Available at: publicsector.practicallaw.com/blog/publicsector/plc/?p=655 [Accessed 1 February 2012].

While most of these followed a more narrowly defined PFI model (see section 2.3), other models of PPP have been used or are attracting significant interest, which include:

- **Balanced Risk Partnerships or** Hybrid PPP – non-standard PPP models which place the public sector and private partners on a more equal footing of risk and reward through, for example, shorter contractual terms, interim payments, guarantees and various degrees of payment by results.
- **Strategic Infrastructure Partnerships (SIPs), Incremental Partnerships (such as LIFT or LEPs) and Strategic Estates Partnerships** - which are intended to be more flexible than standard PPP and which cover a number of discrete development projects. However, each 'sub-project' may still follow a PFI or conventional procurement model.
- **Joint ventures –** for instance where **asset-backed vehicles** built around redundant assets are included in the partnership arrangement to offset the costs of development. The public body may enable the transfer of an asset to the private sector partner who benefits from the increase in the value of the asset in return for developing it.

The challenge with these models is that their hybridity which, while created with the laudable intention of apportioning risk and reward more equitably in order to deliver greater value for money for the taxpayer, can increase complexity, transaction costs and financing costs.

A further weakness offers a clue towards the solution we propose later in this paper. While reliance on the public sector has been tempered and a partnership model introduced, the social sector, communities and citizens are still ignored. Local people most commonly remain oblivious to these structures, their financing, their governance and management. This is a wasted opportunity, in both economic and social terms.

2.3 Private Finance Initiative (PFI)

Introduced by the Conservative Government of the early 1990s, the Private Finance Initiative (PFI) became the infrastructure financing mode du jour of the 90s and early 21st Century. As the Treasury Select Committee reported: "Any Whitehall department could be excused for becoming addicted"[16] to PFI. PFI offered promise in the short-term, but has failed in the long term.

A specific model within the wider PPP landscape, PFI has financed 700 projects over the last 20 years[17] and is still used today. As of 2 May 2012, even as the Treasury is reviewing the use of the PFI, 41 contracts have been concluded under the current government and more than 30 are currently being negotiated.[18] As the Select Committee reported in May 2012, "at

16 HM Parliament (2011) *Committee publishes report on Private Finance Initiative funding* [Online] Available at: http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news/pfi-report/ [Accessed 23 May 2012].

17 HM Parliament (2012) *MPs publish report on equity investment in privately finance projects* [Online] Available at: http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/pfi-equity1/ [Accessed 28 May 2012].

18 Ibid.

a time of public expenditure constraints incentives still exist to use PFI models to provide public assets and services".[19]

There are two significant characteristics of the PFI scheme which may help explain its ongoing attractiveness, despite the significant criticism it receives. Firstly, Government accounting rules have allowed public bodies to account for their future PFI commitments in a way so that they do not appear as liabilities. Although changes to the rules now mean that most projects do now appear 'on balance sheet' in accounting terms, these liabilities still do not appear in the calculation of overall public sector net debt. Furthermore, regardless of the accounting classification, a PFI deal will have less immediate impact on a public body's capital budget than a project procured conventionally.

The second advantage was in the simplicity of the PFI scheme – made possible through the establishment of universal templates, supported by the now disbanded Partnerships UK (PUK). PUK was itself a Public Private Partnership which acted as a centre of expertise for PFI schemes, nationally and internationally, providing advice and templates, key policy guidance and statistics on PFI. These two attributes made PFI, while not without complications, easier to implement across the country and supported its widespread take-up.

However, these advantages masked the problems of the current PFI scheme. Criticisms include:

- A disproportionate profit for private investors
- Perverse incentives for projects to be accounted for 'off balance sheet' even when the liability is retained by the taxpayer;
- Private finance is more expensive than government borrowing (an issue recognised by the Treasury Select Committee earlier[20] this Parliamentary year) whilst risk is not transferred to private partners;
- The presence of a number of hidden costs and the creation of constraints on public bodies' budgetary flexibility that could be passed on for decades down the line;
- Problems with the calculations of costs and benefits;
- The refinancing gains accruing only to the private sector (once famously called the "unacceptable face of capitalism"[21]);
- Lengthy and costly procurement which discourages competition in favour of a small number of contractors; and
- Lack of accuracy and transparency on assumptions, data and estimates of time and costs.

19 Ibid.

20 House of Commons Treasury Committee (2011) *Private Finance Initiative: Seventeenth report of session 2010-12* [Online] Available at: http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146.pdf [Accessed 15 June 2012].

21 Committee of Public Accounts (2006) *Twenty-fifth report: The refinancing of the Norfolk and Norwich PFI Hospital (HC694)* [Online] Available at: http://www.parliament.uk/business/committees/committees-archive/committee-of-public-accounts/pac030506-pn35/ [Accessed 12 June 2012].

Tim Laurence of PA Consulting describes how "demand for public services fluctuates over time… while PFI contracts can usually cope with increased demand (at extra cost) few will reduce their charges as demand falls or in exchange for less ritzy services as departmental budgets tighten."[22] The NAO confirms how "with an average contract period of 25 to 30 years, PFI contracts can be relatively inflexible".[23]

In addition to the structural problems, there are a number of practical and operational issues with the PFI model.

First, with the private sector quite appropriately having a profit motive, rather than a public policy objective, PFI projects becomes driven not by outcomes, for example the regeneration of an area by the creation of new transport infrastructure, and not even by outputs, for example a certain number of stations open and operational, but by the exact wording of the PFI contract.

In the case of the London Underground PPP contracts, for example, these documents were so dense and complicated that it would be impossible for a single individual to understand the full scope of the project. The result was a large number of teams attempting to deliver to the letter of individual sections of the contract, while overall failing to produce a sustainable business model for the upgrade of the underground system.

The second problem is the negotiation and writing of the contracts themselves, where neither party has previously undertaken a similar project and with the Government side often under-resourced both intellectually and in terms of experience. As the National Audit Office points out: "the public sector's skills are generally not as well developed as their private sector counterparts, which puts value for money at risk".

Its merits and challenges notwithstanding, PFI has failed to attract support from citizens and communities. While people are often delighted to visit their new hospital or feel pride in the Building Schools for the Future (BSF) home, the lack of transparency and community engagement in the vehicles at the heart of the PFI schemes (TOPCOs, CAPCOs and OPCOs, etc.) do not engender a sense of community or civic pride, engagement or involvement in the financing of the schemes. While PFI aims to bring in the skills and capacity of the private sector, from the point of view of communities it is still a distant and opaque model. As with public financing, infrastructure development remains something which is done *to them* or *for them,* rather than *by them* or *with them.*

Reviewing these various conventional models, therefore, suggests that there may be scope to develop an alternative financing model that, in the right circumstances, could improve upon their respective weaknesses and engage with local communities to a greater extent. In the next chapter, we suggest how this may be achieved.

22 Laurence, T. (2011) 'Government must get serious about good value PFI alternatives', *The Guardian Public Leaders Network* [Online] Available at: http://www.guardian.co.uk/public-leaders-network/blog/2011/dec/01/serious-pfi-alternatives [Accessed 13 June 2012].

23 National Auditing Office (2011) *Lessons from PFI and other projects* [Online] Available at: http://is.gd/kgOkt3 [Accessed 13 June 2012].

3 Proposing a Community Infrastructure Bond

Inspired by the characteristics, benefits and limitations of public, private and hybrid finance models explored above, our proposal identifies a new model of infrastructure finance designed to embody attributes which:

- Offers sufficiently **attractive investment terms** to a range of institutional and other investors;
- **Structures the public sector contribution** in a way which shares risk appropriately, delivers value for money, accounts for public sector liabilities transparently but which remains as attractive as existing models in terms of public sector balance sheets;
- Identifies a **consistent, simple and transferable model** which minimises transaction costs;
- Aligns incentives between a number of partners, reflecting their mutual interest, and **harnesses the potential of citizens and communities** to make financial and other meaningful contributions to successful infrastructure development.

Whilst not a panacea, at the heart of this report is the idea that in certain circumstances, a Community Infrastructure Bond could offer an optimum combination of the various advantages of the models explored above, thereby promising a practical and attractive model for financing infrastructure development in the UK, particularly in the current economic climate.

Local government has a long history of issuing bonds to finance development. In fact, the Local Government Association is already exploring plans to create a municipal bonds

CASE STUDY

Disintermediation and bonds

Bonds can be issued by public bodies, the private sector and social enterprises. As well as renewed interest in bonds among local authorities, and by large commercial businesses, mutual and social enterprises are also increasingly turning to bonds to help finance their work, whether in the field of housing, retail, infrastructure, social services or other areas. There are a wide range of recent examples of social enterprises and other businesses issuing bonds directly to the retail market:

- Places for People were the first social housing provider in the UK to issue a retail bond on the London Stock Exchange's ORB (Order Book for Retail Bonds) platform. Issued in 2011, the bond raised £140m and pays a fixed gross rate of interest of 5% per year over 5 years. In 2012, Places for People issued a further round of inflation-linked bonds worth £40m.
- The John Lewis Partnership raised £50 through a retail bond at the start of 2011. Bond holders could purchase bonds of a value between £1,000 and £10,000 over 5 years with a fixed annual return - 4.5% in cash and a further 2% paid in John Lewis Partnership gift vouchers.
- In June 2012, the national disability charity Scope, working with Investing for Good, issued bonds following a listing on the Euro MTF Stock Exchange Luxembourg in 2011. It raised £2m so far as a first step toward raising up to £20m.
- The National Grid's first retail bond raised £260m. These 10 year bonds are linked to the RPI index of inflation. National Grid was the first company to issue an RPI-linked bond available to retail investors.

agency to "borrow from the market and then lend to councils".[24] In the 1970s and 1980s, it was standard practice for councils to issue bonds. In Wandsworth in 1979, only 40% of investment raised was via the PWLB and the rest included £60m in "Wandsworth bonds".[25] Recently, Wandsworth Council and the City of Birmingham have been exploring plans to raise finance for major infrastructure projects from institutional investors. According to figures from CLG, over £1 billion of local government borrowing is already financed through negotiable bonds.[26]

The Coalition Government is currently exploring the potential of new central government-backed "Growth Bonds" to raise money directly from citizens to be invested in major infrastructure projects. Reports suggest that the Government are pursuing ways in which savers can invest in infrastructure and impact on Britain's long-term growth. The Treasury has also been exploring how the public sector might take 'first loss' on infrastructure investments through up to £40 billion of new "UK Guarantees", recently announced for nationally significant projects[27]

Certainly, this option may hold potential to channel latent investment from individuals and households. In 2000, UK households had 20.8% of their investments in cash and in 23.3% in shares. But by 2007, even pre-crisis, this had to 26.6% of investments in cash and 15.7% in shares,[28] perhaps indicating a growing level of caution and lack of credible investment propositions. A 2010 survey of long-term savings by the Halifax Bank found that the value of all savings and investments - including pensions, shares and deposit savings - held by UK households has more than quadrupled (305%) in real terms over the past 50 years; increasing from £993 billion in 1959 to £4,024 billion in 2009 (in 2009 prices).The average value of savings and investments per household rose two and a half times (147%); from £59,781 in 1959 to £147,770 in 2009. The value of deposit based savings has also more than quadrupled (328%) in real terms over the past 50 years; increasing from £269 billion in 1959 to £1,153 billion in 2009. Household saving deposits as a share of the value of total savings and investments in 2009 was at 29%.[29] Shifting just a single percentage point from private household savings into Community Infrastructure Bonds would channel over £1 billion towards the financing of our infrastructure.

24 Public Finance (2012) *PWLB rate cuts could kill off council bonds* [Online] Available at: http://www.publicfinance.co.uk/news/2012/03/pwlb-rate-cuts-could-kill-off-council-bonds/ [Accessed 14 June 2012].

25 Public Finance (2011) *Return of the bond* [Online] Available at: http://www.publicfinance.co.uk/features/2011/11/return-of-the-bond/ [Accessed 17 June 2012].

26 Department for Communities and Local Government (2011) *Statistical release: Local authority borrowing and investments – 2010-11* [Online] Available at: www.communities.gov.uk/documents/statistics/pdf/2041385.pdf [Accessed 19 June 2012].

27 Wright, O. (2012) 'George Osborne's latest plan: ask Britain's savers for money', *The Independent*, 6 June 2012 [Online] Available at: http://www.independent.co.uk/news/uk/politics/george-osbornes-latest-plan-ask-britains-savers-for-money-7818038.html [Accessed 19 June 2012]

28 Eurostat (2008) *Households' stock of financial assets by instrument (% of total financial assets), 2000 and 2007* [Online] Available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Households%E2%80%99_stock_of_financial_assets_by_instrument_(%25_of_total_financial_assets),_2000_and_2007.PNG&filetimestamp=20090608084630 [Accessed 19 June 2012]

29 Halifax Bank (2009) UK savings over the past 50 years [Online] Available at: http://www.lloydsbankinggroup.com/media/pdfs/halifax/2010/50YearsofSavingsReportFINAL.pdf [Accessed 18 June 2012]

Recommendation:

HM Treasury should consider how "Growth Bonds" might have potential for even more success if issued by independent community-owned enterprises and by being tied explicitly to more local, tangible and specific projects.

It remains to be seen whether such bonds would be more successful issued at the national level or whether they could attract more popularity targeted at the regional or local level. This may allow such bonds to be more explicitly linked to specific programmes or projects, perhaps at the scale of a local authority, Local Economic Partnership (LEP) or city, with correspondingly greater interest from certain investors (see below). Proposals that are local, and hence more tangible, could give communities a literal stake in their area and, at the same time, increase the attractiveness of the investment.

A more radical proposal designed to meet the above criteria would see bonds issued, not by the local public authority, but instead by a special purpose vehicle (SPV) taking the form of an independent 'Community Infrastructure Vehicle'. At first glance, this seems counterintuitive - as conventional wisdom suggests that there is no more efficient way of raising finance than issuing Treasury debt or local authorities borrowing through the PWLB.

This is not necessarily the case, however. First, as the Public Works Loan Board and public sector borrowing becomes relatively expensive or uncertain. While the Chancellor's recent Budget reduced the Public Works Loan Board interest rate on loans for certain councils, the rate has fluctuated under the current Government, introducing uncertainty and making borrowing less attractive.

Furthermore, there is increasing evidence that socially-conscious investors looking for 'blended returns' are willing to provide capital on sometimes more financially attractive terms than even the Treasury is able to secure. As Cabinet Office Minister Nick Hurd MP outlines, "[w]e know that there are many people in the UK who want to invest in socially motivated organisations but need the tools to be able to do so."[30]

30 The Economic Voice (2012) *Move your money UK backed by minister* [Online] Available at: http://www.economicvoice.com/move-your-money-uk-backed-by-minister/50029594 [Accessed 19 June 2012].

CASE STUDY

Investment for 'blended' economic and social return

In recent years, there has been growing interest from the investor community in social and environmentally conscious investment opportunities whereby investors are willing to sacrifice some financial return in return for 'blended returns'. In other words, it can be cheaper for community-led social enterprises to raise finance than for their more red-blooded private sector counterparts, counter-intuitively making them a more commercially viable proposition. This social connection and community ownership model can offer a cost of capital 'price premium'. Examples include:

- Social investment bonds from **Allia**[31] offer as little as 0% return to investors who are instead attracted by the social impact of their investment. Allia lend the majority of the investment to not-for-profit social housing providers, and the investment grows to at least the size of the original investment over the medium term. This allows them to donate the rest (or the interest foregone by investors) to social causes. To date, they have raised over £10m of investment.
- Debentures issued by **Abundance**[32] (investments in a range of projects selected by the bondholder) and bonds by **Ecotricity**[33] (investments directly in the company) offer arguably less attractive propositions from a purely financial risk and reward perspective than other investment opportunities. Nevertheless, they have succeeded in raising over £10 million in a few years, not least because of their environmental impacts.
- **Welsh Water**[34] argue that their mutual structure can offer them a competitive advantage when it comes to raising bond finance, which is cheaper than the cost of equity. Welsh Water's mutual structure - where members own a utility with a national monopoly - helps reinforce their trusted reputation and popularity with the Welsh Assembly Government. They argue that consequently, investors have little fear of the business being broken up by regulators, which influences the pricing of risk and keeps down capital costs.
- **FC United** of Manchester[35] have raised nearly £1.7m of investment on modest investment terms, including no interest payments in the first three years of the scheme. This illustrates how a sense of ownership and a commitment to the success of an enterprise can encourage investors to look beyond purely financial returns.

31 Allia (2012) *About Allia* [Online] Available at: http://www.allia.org.uk/info/ [Accessed 30 June 2012].

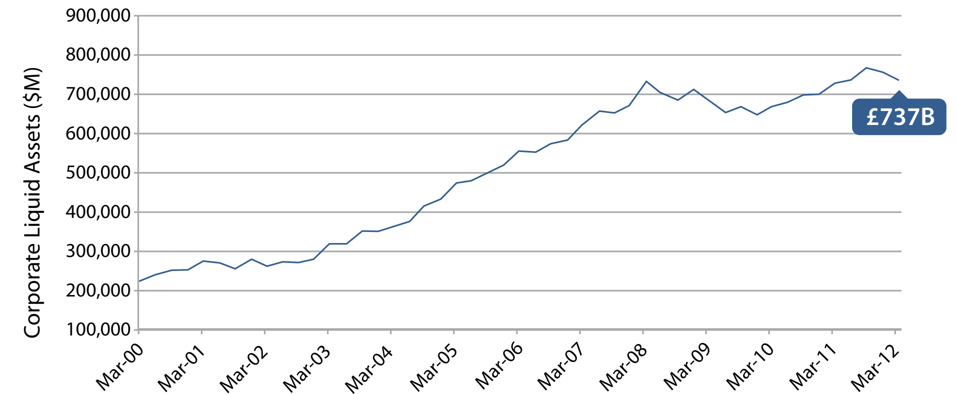
32 Abundance (2012) *The Abundance positive circle* [Online] Available at: https://www.abundancegeneration.com/about/ [Accessed 30 June 2012].

33 Ecotricity (2012) *About Ecotricity* [Online] Available at: http://www.ecotricity.co.uk/about-ecotricity [Accessed 28 June 2012].

34 Welsh Water (2012) *Company Information* [Online] Available at: http://www.dwrcymru.com/en/Company-Information.aspx [Accessed 29 June 2012].

35 FC United of Manchester (2012) *About Fc United* [Online] Available at: www.fc-utd.co.uk/ [Accessed 29 June 2012].

36 Lindsey, M. and Carfang, T. (2012) UK and Eurozone corporate cash briefing, London: Treasury Strategies [Online], Available at: http://www.treasurystrategies.com/sites/default/files/TSI_UKEuroCorpCashBriefing__28June2012.pdf [Accessed 5 July 2012]



Source: Office for National Statistics

Businesses too, could be incentivised to invest in their local infrastructure. According to the ONS, as of 31 March 2012 UK corporate cash levels were at £737 billion. This is high - representing 49% of GDP compared to 21% in the Eurozone and 11% in the United States.[36]

Encouraging even a small proportion of thees resources into investment in infrastructure through our proposed bond structure could do much to revive infrastructure investment. Again, infrastructure itself could be very tangible and serve to impact directly on the local or regional business environment.

Meanwhile, the social sector is even more cash rich on a pound-for-pound basis. While the 2011 Budget suggested that the UK has seen the private sector debt to GDP ratio rise to over 450%[37] , the voluntary sector is relatively underleveraged. The sector's combined assets are worth £109.1 billion, annual income almost £40 billion and liabilities relatively low at just £18.9 billion.[38] This is in comparison to the public sector, arguably at the limit of sustainable borrowing capacity with liabilities as much as assets - both over one trillion pounds[39] - and liabilities potentially twice the size depending upon, among other things, whether PFI obligations are included. So given the challenge we face to find new ways to finance infrastructure development, it seems only appropriate to explore how the sector of the economy with the greatest potential for leveraging further investment may have a greater role to play.

37 HM Treasury (2011) *Budget 2011* [Online] Available at: www.hm-treasury.gov.uk/2011budget.htm [Accessed 14 June 2012].

38 Bass, P. Clarke, J. Kane, D. and Wilding, K. (2012) *NCVO: UK civil society almanac 2012* London: NCVO.

39 Office for National Statistics (2011) *Wider measures of public sector net debt* [Online] Available at: http://www.ons.gov.uk/ons/dcp171766_248137.pdf [Accessed 19 June 2012].

A "Community Infrastructure Bond" would therefore represent a means by which finance can be harnessed off the public balance sheet, on attractive terms, through a principally not-for-profit asset-locked SPV. This would have a legally defined remit to work for a particular community of interest, created with the support of, but neither owned nor controlled by a public authority. Such a model could in certain circumstances be more attractive than a council-issued bond. LEPs could also feasibly have a significant role to play in this process.

For investors to find the proposition sufficiently attractive, they need to be confident that the resources will flow to help deliver the return, blended or otherwise. So these bonds would be underpinned 'underneath the bonnet' by a range of revenue streams. There would be no one-size-fits-all model, with local hybridity and diversity according to the local context supporting a universally recognisable platform for investors. These revenue streams could include a combination of tax receipts, land value capture and conventional public sector commissions, each of which are explored in turn below. Of course, a number of programmes could fall within a consolidated municipal bond, enabling investors to come on board at a programme level and for a number of projects to raise capital more cheaply through collaboration. As the Treasury states: "Few institutional investors have developed the capability to assess direct investment opportunities in individual infrastructure projects."[40] However, as Bruce Davis of Abundance suggests: "The nature of infrastructure projects is moving away from big bang, big bucks single projects towards more distributed and local projects which conventional institutions find harder and more costly to engage with, to price and sell on to a secondary market. The barrier to this is the need for some level of underwriting or support of such projects".[41] It is these distributed projects which have the potential to tap into a greater variety of funding.

In order to minimise transaction costs and complexity, standardised frameworks could be developed, learning from the lessons of the work of Partnerships UK with regard to PFI. This can help provide a familiar platform for financing a range of diverse underlying programmes and projects.

A bond instrument provides simplicity and clarity for investors, above all, around return, risk, liquidity, duration and security. But for it to be sufficiently secure and attractive to investors and to achieve the appropriate credit rating, it could be de-risked through one or more of the conventional levers available to the public sector: guarantees, tax breaks and/or relatively small levels of investment.

First, public sector guarantees may provide credit enhancements. One example is the new "UK Guarantees" of up to £40 billion for nationally significant projects. The Treasury explains how for underwriting investments under the National Loan Guarantee Fund, "Guarantees issued under the scheme are expected to be contingent liabilities, with no impact on public sector net debt."[42] In the 2011 National Infrastructure Plan, the Treasury first suggested they would provide "guarantees when investors cannot accommodate certain risks. The Government will, subject to affordability, consider using transparent forms of guarantee to support specific projects where this provides best value for money for taxpayers and users, recognising that the private sector cannot always bear every risk in major new projects. In line with this, the Government recently confirmed its openness to provide contingent financial support for exceptional risks in the construction of the Thames Tideway tunnel".[43]

Tax incentives could be a further way of enhancing the attractiveness of such bonds, whereby tax breaks can reduce the cost of capital for investors. Of course, this has direct implications for Exchequer receipts. But if the exploitation of existing tax breaks can enable multiples of the tax receipts foregone to be raised, with the consequent impact on the competitiveness of the UK economy, which in turn leads to greater receipts, then this is more than a zero-sum game. Relevant tax breaks are likely to include a combination of the Venture Capital Trust scheme, Community Investment Tax Relief and the Enterprise Investment Scheme (or even better, through improvements on these flawed incentives to better incentivise longer-term more sustainable investment). As the Local Government Association and British Property Federation similarly argue, the Government should "ensure that local authority bonds, and those issued by collective local government funding agencies, to fund growth-supporting infrastructure have maximum tax efficiency to reduce the costs of borrowing. This would mean enabling councils and collective local government funding agencies to pay interest free of withholding to a wider range of investors and that investors should not be taxed on income or gains arising from investment in such bonds."[44]

Recommendation:

HM Treasury should review fiscal incentives such as Community Investment Tax Relief, Venture Capital Trust and Enterprise Investment Scheme to ensure they create the right incentives for more sustainable long term investment.

Recommendation:

Recommendation: HM Treasury and pioneering local authorities should explore the various means at their disposal for underwrite the risk of bonds raised by Community Infrastructure Vehicles through a 'first loss', equity tranche or guarantee model.

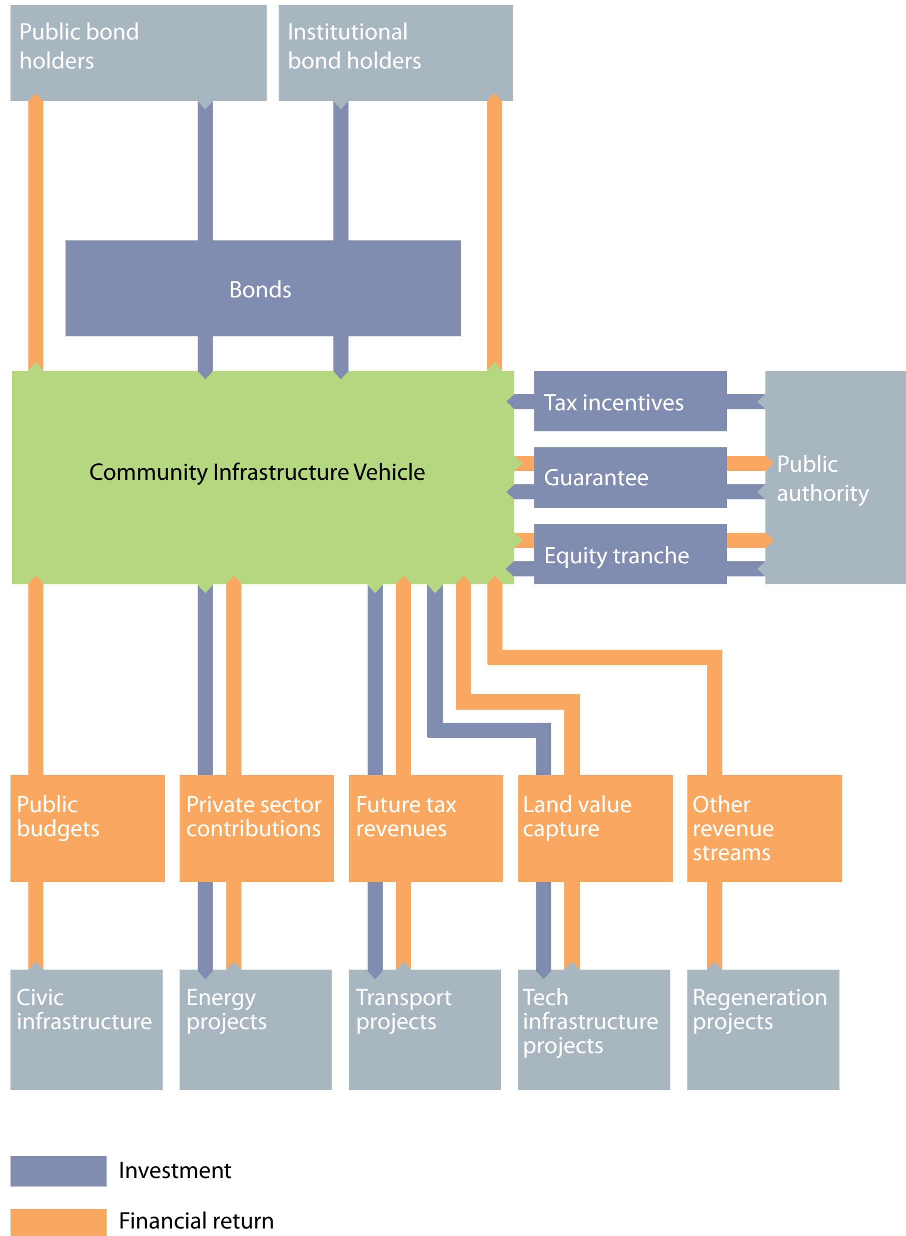
40 HM Treasury (2011) *National Infrastructure Plan* [Online] Available at: http://cdn.hm-treasury.gov.uk/national_infrastructure_plan291111.pdf [Accessed 20 June 2012].

41 Conversation with Bruce Davis.

42 National Loan Guarantee Scheme (2012) *National Loan Guarantee Scheme: How it works* [Online] Available at: http://nationalloanguaranteescheme.co.uk/business-loan-guarantee-scheme-how-it-works [Accessed 16 June 2012].

43 HM Treasury (2011) *National Infrastructure Plan* [Online] Available at: http://cdn.hm-treasury.gov.uk/national_infrastructure_plan291111.pdf [Accessed 20 June 2012].

44 Local Government Association and British Property Federation (2012) *A pre-budget submission* [Online] Available at: http://www.local.gov.uk/c/document_library/get_file?uuid=88870572-9019-406f-b9b1-84b157da4a18&groupId=10161 [Accessed 12 June 2012].



Third, public bodies (or a new GIB-style quasi-public body for instance) could invest a risk investment or 'first-loss' tranche in the SPV, with the benefit of de-risking the debt tranches while also reversing the problematic characteristics of PFI whereby private investors stand to earn uncapped returns on the upside. Rather, in the case of successful schemes under this model, it would be the public sector which stood to benefit significantly from excessive profits.

A further benefit of this proposed model is the way in which the formation of SPVs outside the constraints of public administration could provide a focal point for self-defining communities of interest - public, private, social or individuals - to develop projects and programmes for infrastructure delivery, across rigid public sector boundaries and beyond the uncertainty of political cycles. By enabling diverse partners to choose to come together through mutual interest, rather than being subject to top-down fiscal and administrative regimes, the proposed model increases the potential for greater flexibility, innovation and value for money yet at the same time, the security of freedom from political interference.

Recommendation:

Local authorities, should come together to explore the development of the Community Infrastructure Bond model outlined in this paper, perhaps facilitated by a representative or membership body such as the Local Government Association

Finally, Community Infrastructure Bonds would provide the opportunity for citizens and communities to engage more directly and meaningfully in the financing of infrastructure development. Such vehicles would enable an improved, more transparent, diverse and democratic governance. Improving upon the model of Local Improvement Finance Trusts (LIFTs) or Local Education Partnerships (LEPs) the financial vehicles at the heart of the scheme, instead of dry and anonymous SPVs, would themselves be social enterprises subject to greater control and influence from the community of interest which they are intended to serve.

CASE STUDY

The Argyll and Bute PFI model

Latter-era PFI models evolved to address some of the criticisms of the PFI scheme. For example, a non-profit distributing (NPD) model pioneered in Argyll & Bute was structured to ensure returns to private investors were capped. By replacing equity investment with a combination of senior debt and junior debt (mezzanine, subordinated or preference shares) any profits would be recycled via a charity for the benefit of the local community.

This model won awards and interestingly, the Government's own PFI experts reported other benefits emerging from the NPD model, including:

- Improved governance with independent stakeholder directors from the local community acting as guardians of the public interest and with levers over behaviour beyond contractual terms
- Improved alignment of long term public and private sector interests
- Increased stability of long-term ownership and control
- Greater stakeholder acceptance

The model allows the exciting possibility of harnessing added value through 'democratising' or 'socialising' finance – where local residents might act either as investors or play a role in servicing the investment (see below). This not only strengthens the links between where citizens place their money and their vested interests as members of the local community, thereby better aligning incentives between capital and communities through placing the ownership and control of local infrastructure in local hands, but also opens up a wider range of financing sources.

Recommendation

Where public bodies continue to use PFI models, they should take on board the lessons from the likes of the Argyll and Bute model, ensuring greater transparency and channelling community engagement into investment opportunity.

4 Underpinning the bond: Revenue streams

Conventionally, bonds have been underwritten by taxation. But this is just one potential income stream to underpin the model we propose. A range of revenue streams could be harnessed to improve the viability of each bond. As the Core Cities report recognises: "In reality, most schemes are funded through a cocktail of financial mechanisms from both public and private sources."[45]

45 Core Cities Group and the British Property Federation (2010) *A rough guide to tax increment financing* [Online] Available at: http://www.bpf.org.uk/en/files/bpf_documents/A_Rough_Guide_to_Tax_Increment_Financing.pdf [Accessed 21 June 2012].

Our proposal for Community Infrastructure Bonds seeks to describe the vessel for serving these 'cocktails' in a way that the market can recognise, enabling potential customers to understand the risks.

These revenue sources would reflect the various communities of interest brought together with a mutual interest in the success of the development of local infrastructure. This may include any combination of public bodies, private businesses, citizens and others and could be harnessed simultaneously in combinations of different proportions depending on the context and conditions.

The terms of the contribution made by each may vary in price, risk and complexity, proportionate to the value each partner expects to see realised from the partnership but would be agreed in advance of the bond issuance. These could include, among others:

- Commissions from public budgets funded through conventional and supplementary taxation;
- Private sector contributions and planning gain;
- Future tax revenues (such as Tax Incremental Financing);
- Land Value Capture;
- Other revenue streams such as efficiency savings, asset transfers, statutory charges, fees and levies and community and citizens' contributions.

4.1 Public budgets and supplementary taxation

Regardless of the various financing models on offer, the state will continue to play a central and crucial role in commissioning and funding the UK's essential infrastructure. Public works will rely on significant contributions from existing public budgets, raised through conventional or supplementary taxation. These streams therefore provide a potential contribution to the funding of Community Infrastructure Bonds.

The Business Increase Bonus scheme, enabled through the Business Rate Supplements Act 2009, allows upper-tier local authorities to levy a supplement on business rates in their area to fund economic development projects. The most high profile example was the supplement levied by the Mayor of London in order to part-fund the Crossrail programme.

CASE STUDY

Crossrail rates levy

In 2010, the Mayor of London, Boris Johnson, introduced a levy of 2 pence on non-domestic properties with a rateable value of over £55,000 in London. The intention was to help fund Crossrail, the east-west train link across the city. The GLA expects to contribute "around £4.1bn of its agreed contribution to the £15.9 billion Crossrail project using income generated from a new business rates supplement" which fall on around one in five businesses.

However, conventional or supplementary taxation may not fall proportionately on those to whom the benefits of development accrue, or may be regressive in certain circumstances, raising issues of fairness. The Crossrail supplement, for example, is universal and falls on those businesses who stand to benefit directly as well as those who will see little benefit, and even on those who may be placed at a competitive disadvantage as a result of new transport patterns. Seen in this light, it is a blunt and for some, a rather painful instrument.

Recommendation:

Local authorities considering models of supplementary taxation should take into account how it might be introduced in way that is fair and progressive.

There can also be challenges in terms of the ability of public bodies to commit budgets over the longer-term - given budgetary planning cycles and democratic timetables - and across conventional spatial and administrative boundaries. This latter challenge may be partly addressed through the new 'Duty to Co-operate',[46] enshrined in the Localism Act (which aims to "ensure that local authorities and other public bodies… will maximise effective working on development planning in relation to strategic planning issues that cross administrative boundaries"). Local authorities thus have an obligation to co-operate across conventional administrative boundaries, potentially to pool planning gain, for example.

Recommendation:

Local authorities should consider their duty to co-operate in terms of the value for money to be secured through the pooling of planning gain.

46 HM Government (2011) *Localism Act 2011* [Online] Available at: http://www.legislation.gov.uk/ukpga/2011/20/section/110/enacted [Accessed 10 June 2012].

Finally, in exploring how public spending can underpin our proposed bond model, it is crucial to consider that public spending should not crowd out other potential revenue streams and must not be seen as the only game in town. To do so would be to place an unnecessary burden on existing public budgets and to sacrifice value for money for the taxpayer, when money could be attracted from other non-statutory sources. There is arguably a moral imperative here – that those who stand to disproportionately reap private rewards from public investment should contribute accordingly towards the costs of development.

4.2 Private sector contributions and planning gain

Planning gain refers to taxation or levies applied, linked to increases in the value of land resulting from the granting of planning permission. The current mechanism to capture financial contributions from developers and landowners is through Section 106 Agreements, which as CLG describe it allows "councils to require developers to make payments to mitigate the impacts of new development, using a system known as planning obligations."[47] Section 106 has become a well-established vehicle through which developers contribute to infrastructure and services that local public bodies believe are necessary to support or reduce the impact of a proposed development. These are sometimes also called 'negotiated exactions'.

The previous Government originally legislated for a new Community Infrastructure Levy (CIL) in the 2008 Planning Act. The Coalition Government have outlined how they want "a transparent and fair system whereby developers make a contribution towards additional infrastructure that is needed as a result of their development, and which gives power to councils and communities to make their own decisions on planning issues."[48] Accordingly, the Community Infrastructure Levy (Amendment) Regulations 2011 came into force on 6 April 2011. In Scotland, the equivalent is a Section 75 planning agreement. Negotiated planning obligations under section 106 will continue as CIL is introduced.

The Local Government Association and the British Property Federation agree that the CIL "has the potential to contribute significantly to infrastructure provision[49]". As the DCLG suggest, income from the CIL can be used to "support development by funding infrastructure that the council, local community and neighbourhoods want - for example new or safer road schemes, park improvements or a new health centre.[50]" It aims to provide greater flexibility and freedom than the previous regime and enables local authorities to "allocate a share of the levy raised in a neighbourhood to deliver infrastructure the neighbourhood wants."

47 Local Government Improvement and Development (2010) *Section 106 Agreement* [Online] Available at: http://www.idea.gov.uk/idk/core/page.do?pageId=71631 [Accessed 9 June 2012].

48 a transparent and fair system whereby developers make a contribution towards additional infrastructure that is needed as a result of their development, and which gives power to councils and communities to make their own decisions on planning issues

49 Local Government Association and British Property Federation (2012) *A pre-budget submission* [Online] Available at: http://www.local.gov.uk/c/document_library/get_file?uuid=88870572-9019-406f-b9b1-84b157da4a18&groupId=10161 [Accessed 12 June 2012].

50 Department for Communities and Local Government (2011) *The Community Infrastructure Levy* [Online] Available at: http://www.communities.gov.uk/planningandbuilding/planningsystem/communityinfrastructurelevy/ [Accessed 5 June 2012].

Recommendation:

Local authorities should explore how they may use the Community Infrastructure Levy creatively and flexibly to help contribute to the funding of infrastructure provision.

CASE STUDY

Crossrail and the The Mayoral Community Infrastructure Levy

In Spring 2012, the Mayor of London Boris Johnson introduced a Community Infrastructure Levy (CIL) charging schedule on new developments across London to help fund the Crossrail line. The target is for the levy to raise £300m toward the project. A developer's contribution towards the CIL is expected to be carved out from the Section 106 planning gain contributions which might have been made in any case towards the provision of public transport and other public services which were required by the development. The intention therefore is simply that Crossrail takes priority over other transport funding requirements within the planning gain system.

The principle behind the Mayoral CIL is that Crossrail represents such a major contribution to the transport system across the capital, the equivalent of a 16% increase in capacity for the whole underground and rail network of London. It should be a uniquely impactful project and will generate a considerably greater and wider benefit than, for example, an extension to the DLR. Therefore, every new development, even those in areas not served by Crossrail, would benefit from the improved transport capacity and connectivity and general economic growth in London delivered by the project. The Mayoral CIL is formed into three zones, with Central London paying £50 per square metre of development, and outer London to the extreme North and South, away from the Crossrail line, paying £20 per square metre.

Canary Wharf Group had originally proposed a £30 per sq. ft. (Net Internal Area) levy for all developers who would benefit from the new railway, committing to pay this levy in advance as part of the funding package on the Canary Wharf Crossrail station. By making this contribution and also redesigning the station and taking on scheduling and construction risk to reduce costs, Canary Wharf Group were able to reduce the cost of the total Crossrail project to Government by approximately £750m compared to original estimates. Crossrail is now under construction and when it opens in 2019 Crossrail will enable a further wave of development at Canary Wharf as well as at several other points along the line. The estimated employment capacity of the Canary Wharf business district is 200,000 people, double the current working population.

When the Crossrail project funding target has been reached, the Mayor will have a number of options. The current proposal envisages that the Mayoral CIL will raise the £300m contribution towards Crossrail and then stop. This is straightforward but inequitable. A single generation of developers will pay the levy despite development coming forward the day after the CIL is dropped will still benefit from Crossrail in the same way, but not pay the Mayoral CIL as those earlier developers did.

A second option would be to continue to charge the Mayoral CIL on further developments to further reduce the costs of the Crossrail project to the public sector. This raises the question of when the CIL would stop. Would developments in 2050 still contribute towards the cost of Crossrail? There is an argument that they should, as the infrastructure will still be in place and their developments will still benefit from it. Over 50 or 100 years the Crossrail CIL might pay for the construction of the whole line several times over, leaving the public sector in surplus on the deal.

A third option would be the continued charge of the CIL but leading to further projects such as Crossrail lines 2 and 3.

Finally, the CIL could be de-hypothecated from Crossrail and used to create, for example, a Mayoral Infrastructure Fund, which could be used to fund any transport projects across the city. This might be the fairest system to satisfy arguments from developers who believe Crossrail has little direct benefit to them. However, at this point the CIL would simply become a permanent London-wide development tax.

So the CIL can be seen to be 'fishing in the same pond' as Section 106, generated from developers at the point of development. When taken alongside affordable housing obligations and other development costs, the cumulative effect can create a risk of overfishing which can have a detrimental effect on the prospects of development by making projects less financially attractive up front and may tip some projects from viable to non-viable.

Agreeing contributions up front from existing public and private budgets are likely to continue to form a crucial part of the mix of funding developments for some time. But increasingly, with pressure on current spending, interest is gathering in how to weave in potential increases in future tax revenues accruing directly from the new infrastructure.

4.3 Future tax revenues

Tax Incremental Financing (TIF) is the Great White Hope of infrastructure financing, not least through the 'buy now, pay later' attributes it shares with PFI. It has been argued that TIF can enable infrastructure development when "funding cannot be found from other, public or private, sources. TIF allows more upfront money to be raised by committing incremental business rates – i.e. revenues which would not have arisen but for the project going ahead – to be used to repay that initial investment. It isn't going to help every worthwhile project, but it will allow some stalled schemes to go ahead." [51]

The TIF model assumes that landlords and tenants, commercial and residential, new and old, stand to benefit from new infrastructure development, through an improved business environment, transport links and quality of life, for example. This in turn will drive an up-lift in future tax receipts.

In the United States, TIFs have become a ubiquitous and well established method of funding regenerative development, having operated since 1952. In California, where TIFs were pioneered, there are currently more than 400 TIF schemes with a combined annual income of over $8 billion, servicing a debt of $28 billion.[52]

While TIFs started as a means of funding public infrastructure, in the US they have become used increasingly to deliver a public sector funded boost for essentially private sector projects such as shopping malls, typically in the form of a tax break. For example, a small town with economic difficulties identifies a shopping mall as a project to revitalise the local economy, create jobs and raise tax revenues. In addition to the tax revenue on sales and rents paid by the mall tenants, the town will become a more attractive place to live and this will correspondingly raise property values and potentially generate new residential development. This will in turn raise residential property taxes. The local authority offers a long-term tax break for a private sector operator to create the mall. The private operator can borrow against this tax break, build the mall and attract tenants. Assuming the mall is successful, tax revenues increase, and over time, pay back the initial loan. TIF can work particularly well for regeneration projects where a relatively small investment generates significant uplift in local revenue.

51 British Property Federation (2012) *What we do – Tax Increment Financing* [Online] Available at: http://www.bpf.org.uk/en/what_we_do/Finance/tax_increment_financing.php [Accessed 10 June 2012].

52 California State Controller's Office (2011) *Redevelopment Agencies Annual Report* [Online] Available at: http://www.sco.ca.gov/ard_locrep_redevelop.html [Accessed 10 June 2012]

CASE STUDY

Worcester Medical Centre, Massachusetts

An example of a TIF delivering both regeneration and a public health improvement is the creation of the Worcester Medical Centre in Massachusetts. The city government offered a tax break to the St Vincent's Hospital over 18 years, allowing the Hospital to spend $250m to create a new Medical Centre, shopping mall and restaurants on a derelict site. The Centre has dramatically improved Worcester's tax revenue base and has created 117 new full time jobs and 215 part time jobs so far. After 18 years the tax incentives will be phased out and the City will benefit from the full amount of additional taxation from the Medical Centre. However, in the meantime, the City has benefitted financially from the operation of the Centre attracting new business and regenerating the area.

The Medical Center TIF is just one of a total of 23 TIFs operating in Worcester, a city with a population of just 181,000 making it comparable to Sunderland or Preston in terms of size. Other TIFs in the city have paid for a new theatre to be developed and a new business park.

TIF is now being trialled in Scotland, following legislation passed by the Scottish Parliament in December 2010 to approve the use of TIF for six projects. The Scottish Futures Trust has been asked by the Scottish Government to lead on implementation of TIF.

The new Local Government Finance Act enables councils in England and Wales to retain a portion of any uplift in business rates within their domain. This enables Tax Incremental Financing by giving councils the opportunity to invest on the basis of their potential share of an up-lift in future business rates. Legislation allows local authorities to factor in the full benefits of growth in local business rates income when forecasting future income. But initially, at least, Government will limit the number of TIF schemes that are allowed. The 2012 Budget committed investment towards TIF projects of up to £150 million available from 2013–14. TIF schemes were announced in eight cities across England, including Bristol and Manchester, via an expanded 'earn-back' model where "an element of tax revenues raised – either as corporation tax from firms working on construction or from new businesses paying business rates – would be returned for further investment[53]".

53 Public Finance (2012) *PWLB rate cuts could kill off council bonds* [Online] Available at: http://www.publicfinance.co.uk/news/2012/03/pwlb-rate-cuts-could-kill-off-council-bonds/ [Accessed 14 June 2012].

CASE STUDY

Battersea and Northern line extension TIF

In Autumn 2011 Chancellor George Osborne made the unusual step of identifying a specific regeneration project in London in his Autumn Statement. He said that the Government would make the necessary arrangements to bring forward Tax Incremental Financing (TIF) to help fund the £950m extension of the Northern Line to Battersea Power Station. This would create new Underground stations at Battersea and Nine Elms.

The idea of using a TIF to help kick start regeneration has been championed by Transport for London under both Ken Livingstone and Boris Johnson. This is partly because when Mayor Ken Livingstone appointed American Bob Kiley as his Transport Commissioner, he brought with him a group of finance experts with experience of TIFs in the USA.

In the UK, TIFs will require specific central Government permission to operate within an enterprise zone or other special geographical designation. This will enable the local authority, (probably the Mayor in the case of Battersea working together with Wandsworth Council) to borrow against future tax revenue to provide up front funding for the project.

Different projects are planned using TIFs in Edinburgh, Ravenscraig, Sheffield, Leeds and Manchester. The Scottish Executive has already signalled its approval of the Ravenscraig and Edinburgh schemes.

The Core Cities Group and British Property Federation have been arguing for TIF (or Accelerated Development Zones) for a number of years. They describe how "The UK TIF model is based on reinvesting a proportion of future business rates from an area back into infrastructure and related development. A lead agency – a local authority, private sector partner or some combination – raises money upfront to pay for infrastructure, on the basis that the increased business rate revenues generated by the scheme can be used to repay that initial investment. The upfront funding may be borrowed from public or private sources, or it may be provided by the developer from capital available to it.[54]"

Intriguingly, the lead agency here is not necessarily the local public body. It has been suggested that social housing providers could propose schemes. Similarly, under our proposed bond model, the bond issuer, or borrower would be assigned the rights to a proportion of future tax revenues, helping underpin the model.

54 House of Commons Library (2012) *Tax Increment Financing* [Online] Available at: www.parliament.uk/briefing-papers/SN05797.pdf [Accessed 12 June 2012]

Recommendation

The Core Cities group and the Mayoral cities should explore how TIF models could help underpin "City Bonds" issued in partnership with, but by bodies other than the local authority themselves, including housing associations, CDFIs or special purpose community investment vehicles.

In the 2011 National Infrastructure Plan, the Government outlined how, for development in Battersea "we will consider allowing local borrowing against future receipts of CIL to support this, subject to commitment by April 2013 from a developer to contribute and develop the site".[55] The Government will also consider allowing City Mayors to borrow against future CIL receipts where this can "make a significant contribution to national infrastructure"[56] (potentially opening up unique advantages for the few cities electing a Mayor, such as Bristol). Different projects are planned using TIFs in Edinburgh, Ravenscraig, Sheffield, Leeds and Manchester. The Scottish Executive has already signalled its approval of the Ravenscraig and Edinburgh schemes.

The Local Government Association and the British Property Federation urge the Government to "use its powers in the CIL legislation to… allow developers, with the agreement of a local authority, to deliver infrastructure which is wholly or partly funded through CIL themselves, and then deduct the value of the infrastructure from their CIL liability.[57]" In essence, this turns the tax and spend model on its head and instead, enables others to finance the development in return for reducing their future tax liability.

There are perhaps significant challenges and limitation to TIF, which are yet to be crystallised in the UK as the model is still in its infancy. It has been argued that the TIF model does not actually generate additional tax revenues but simply moves tax revenues from one administrative area to another. The US has seen some evidence of competing TIF schemes with a potential 'race to the bottom' in terms of tax revenues. The Core Cities Group, one of the more vehement champions of the scheme in the UK, admit that "there may be some displacement in some schemes" and that "UK TIF isn't the right tool for every scheme[58]".

55 HM Treasury (2011) *National Infrastructure Plan* [Online] Available at: http://cdn.hm-treasury.gov.uk/national_infrastructure_plan291111.pdf [Accessed 20 June 2012].

56 HM Treasury (2011) *Autumn Statement* [Online] (29 November 2011) Available at: cdn.hm-treasury.gov.uk/as2011_chapter_1.pdf [Accessed 24 June 2012].

57 Local Government Association and British Property Federation (2012) *A pre-budget submission* [Online] Available at: http://www.local.gov.uk/c/document_library/get_file?uuid=88870572-9019-406f-b9b1-84b157da4a18&groupId=10161 [Accessed 12 June 2012].

58 Core Cities Group and the British Property Federation (2010) *A rough guide to tax increment financing* [Online] Available at: http://www.bpf.org.uk/en/files/bpf_documents/A_Rough_Guide_to_Tax_Increment_Financing.pdf [Accessed 21 June 2012].

The catch is when when neighbouring and rival town share the same ambitions. The comparative attraction of a second large shopping mall in close geographical proximity is less with consequently less economic and financial impact. So although TIF funded projects can stimulate growth, the viability of TIF relies on a growing national economy. In good years, everyone can have a new shopping mall and the benefits that accrue. In bad years, not only do the malls fail, but the local authority can be saddled with a long term TIF deficit.

Recommendation:

Recommendation: HM Treasury and the Department for Communities and Local Government should commission an independent study to explore the effect of TIF models on competition between local areas (e.g. raising the game for all or a race to the bottom and identifying the unintended consequences).

The Department for Communities and Local Government admit that "councils have greater incentives to grant planning permissions", which reveals the potentially perverse incentives and unintended consequences of the scheme whereby the direct financial imperative to deliver an up-lift in business rates overtakes softer concerns. A typical example is how out of town shopping developments can impact negatively on established market towns, or on flood plains, for example.

Other challenges include the potential complexity and how, as with other publicly funded models, the link to local authority areas may hinder the development of schemes or programmes which fall across wider boundaries. Local Economic Partnerships and the 'duty to co-operate' may have a role to play in mitigating these risks.

4.4 Land Value Capture

Land Value Capture (LVC) is a close cousin of TIF. LVC models seek to capture potential value (rather than tax) uplift resulting from infrastructure development to secure contributions to their funding. The LVC model recognises that not only public bodies and private partners can gain from the development but also the wider community. In other words, the ambition is to capture a proportion of the private benefit of public goods in order to help fund their development. The principal beneficiaries of enhanced property values are likely to be the owners or long leaseholders of the property within a designated area.

Land value capture in relation to transport projects can be understood as a mechanism "by which the agency responsible for the development of the urban transport infrastructure captures part of the financial benefits gained by land developers or the community at large. This benefit is reflected in an increase in the real property values, which can be regarded as a comprehensive index of all the benefits generated by the development, including improved accessibility and an increase in business opportunities".[59]

Typically transport infrastructure, for example, improves accessibility which in turn can be expected to increase the value of commercial and residential property or an increase in property development and redevelopment opportunities. While this can sometimes be negative (if residential property is immediately adjacent), more commonly it can lead to a combination of uplift in the value of existing property in their current use and the increasing viability of redevelopment or new development on vacant land and an upward impact in its value. So this is about both land and property, not least because the value of land cannot be isolated from that of the buildings or occupiers. The model could perhaps be more accurately referred to as "value capture funding" or "value increment funding".

"Betterment Tax" is a term which has been used to describe models which closely identify beneficiaries of a development and which tax changes in land value closely tied to the development. Hong Kong and Singapore have experience of partly financing their underground rail systems through betterment taxes.

To some extent this uplift in value may be captured through the existing taxation system as mechanisms already exist to record – and tax – the quantity and value of all residential and commercial property. Furthermore, the planning gain model "in turn offers an opportunity to capture some or all of the increase in value as a contribution to the infrastructure improvements that created it" But there are various other ways in which a range of "value capture mechanisms" could be deployed to harness these impacts. The point at which uplift is assessed could be established as the point of sale and manifest as a profit share or sell-on fee.

There are potentially significant advantages and disadvantages of land value capture models vis-à-vis other models for financing infrastructure development. A principal challenge is the potential complexity in seeking to develop a robust methodology for quantifying changes in land and property values, particularly residential, and accordingly, significant transaction cost as each context is different. It is imperative to be able to forecast and measure value change sufficiently to provide sufficient confidence around future revenue flows to attract investors. There is also a potential tension between fairness and simplicity while attribution and deadweight also present further challenges to the development of appropriate metrics. But a LVC model should be as feasible as a TIF model.

59 Tsukada, S. and Kuranami, C. (1994) 'Value Capture: The Japanese experience', *PTRC financing transport and infrastructure pp. 177-185.*

CASE STUDY

Hong Kong

For decades, land in Hong Kong was owned by the public and leased to the private sector. Thus, the Hong Kong government was able to capture a significant proportion of land value increases from the 70s to the early 90s. In the Hong Kong Metro system, land, station retail units, advertising in trains and stations, licence to develop residential property, shopping centres and offices are leased by the state to the MTR Corporation over the long-term. The system was developed by the Government in 1973 as the only shareholder, putting up a third of the initial investment. The Hong Kong Government subsequently capture rent from the publicly owned land, which had already turned a profit by the early 80s, partly due to increases in adjacent land value.

Furthermore, land value capture models have been most commonly associated with transport development schemes and may not be as applicable to other infrastructure development, such as waste processing, for instance, youth offending institutions or prisons.

Finally, these approaches may involve the introduction of new instruments for capturing value and may require primary legislation. Even advocates of the model suggest that "it is disingenuous to use a standardised model of land value finance that may be replicated across cities. Relevant stakeholders such as local authorities should consider the range of financing options before deciding which tool or instrument or method is most appropriate for a city and a particular project.[60]"

Yet compared to other models, LVC offers the potential for greater value for money for the public sector, more equitable sharing of risk and reward among a wider group of relevant stakeholders and more appropriate aligning of incentives between partners. A further benefit is that in a more economically challenging environment when house prices, land prices and the value of commercial property are not rising, projects that are tied to potential increases in the value of property could be attractive to commercial landlords. Similarly, in more austere times when house prices are not rising, one can argue that a project which will increase the value of adjacent property could be of interest to homeowners. We know that the proximity of a good school can raise house prices in an area, even for those residents who will not make use of the school. Small changes can have major effects on land value as they raise the overall quality of the locality.

60 Medda, R, F. and Modelewska, M. (2010) *Land value capture as a funding source for urban investment: The Warsaw metro system* [Online] Available at: http://www.ucl.ac.uk/qaser/pdf/publications/ernst_young [Accessed 1 July 2012].

Recommendation

One or more pioneering local authorities, cities or LEPs should establish Value Capture Vanguards to explore how property and land value capture mechanisms could support infrastructure financing with particular regard to landowners, landlord and long-term leaseholders. The Treasury and the Department of Communities and Local Government should encourage the establishment of these Value Capture Vanguards.

4.5 Other revenue streams

There are a number of other potential revenue streams which could be harnessed to further underpin the viability of the bond model. These include concessions, fees and charges, statutory charges, parking levies and congestion charging. Leveraging investment from local communities and business also has much potential to harness and deliver local social, economic and environmental return.

Asset transfer can also further support the viability of schemes, where an asset-backed model can contribute to the overall viability of the development and its financing.

CASE STUDY

Asset Transfers: Croydon Council Urban Regeneration vehicle

Croydon Borough Council has established a strategic joint venture property partnership to deliver development and investment in the borough. The Croydon Council Urban Regeneration vehicle, established in 2008, is a 28-year exclusive partnership between Croydon Council and John Laing to regenerate a range of key sites across Croydon borough.

The partnership involves the use of an asset backed Urban Regeneration Vehicle (URV) and was set up as a 50:50 partnership, with Croydon Council investing land in the URV and with John Laing investing equity.

Initially CCURV will be delivering a £450m regeneration of significant sites across Croydon town centre with the aim of helping achieve the Council's regeneration objectives, unlocking land value and delivering development profit to the partnership.

Finally, there may be schemes which capture public imagination (such as sports or leisure facilities, for example) whereby it is possible to capture relatively small amounts of money from a relatively large amount of local people.

CASE STUDY

Fordhall community investment

While community investment is on the rise, so it seems is the incidence of citizens coming together to fund something they care about, even with no prospect of financial return. This has included enterprises, buildings and other projects as diverse as piers, football clubs, farms and churches, kidney machines and historic homes. The Plunkett Foundation has helped to establish several hundred community-owned shops, most funded through voluntary contributions.

Fordhall is a 128-acre organic farm in Shropshire which raised the purchase capital from the community. In 2006 a group of supporters bought the farm for £800,000 and secured it for community access.

Over 7500 people bought £50 shares while not expecting any financial return. The farm now works to develop viable educational, heritage, environmental, nature trail and social activities with the community for social, economic and cultural benefits.

There may also be potential revenue streams to be harnessed from efficiency savings, both financial and from energy efficiency savings which reduce both costs and negative externalities. If the benefits of further reduction in management costs accrue, at least in part, to the investors - unlike PFI - incentives can be aligned so that if costs decrease then the viability of the bond increases accordingly.

The challenge with many of these revenue sources is the potential complexity and resulting transaction cost. The benefits, however, are potentially significant, through models which engage citizens and communities and which can deliver social, economic and environmental benefits.

5 Conclusions and Recommendations

The UK economy is battling through turbulent times. If we are to prosper through the 21st Century then we need to grasp the appropriate tools to renew the underlying structures of our economy which support growth, employment and enterprise.

For too long, infrastructure finance has been conducted as an antagonistic tussle between the public and private sectors. We need to look beyond the public sector whilst allowing the state to play an enabling role as a cornerstone investor. We need to reach out to the private sector without ceding undue ownership or profits. We can deliver better value for money, more popular and longer-term models of infrastructure finance if we embrace communities, as engaged investors, participants and sponsors of the physical assets that ensure their wellbeing.

There is real potential here, underscored by recent proposals for 'Growth Bonds' and this potential needs to be harnessed. Businesses, citizens and institutional investors are sitting on the resources we need, poised to invest if only the sound, sustainable and responsible investment vehicles are made available to them.

The bond vehicle we describe allows for a variety of income streams to underpin its viability based on the the distinct characteristics of diverse localities.. From the standpoint of investors it can offers stability and certainty – with public support which can mitigate risks and deliver a shared returns between the public and private sector and civil society.

Such a bond creates an intriguing opportunity for citizens and communities to engage more directly and meaningfully in the financing of infrastructure development. We can learn much from forgotten and emerging models of alternative, peer-to-peer, social and community finance, the development of community enterprise, community owned assets and social enterprise to help us offer towards future models of infrastructure finance.

We hope to see the emergence of financial vehicles which can enable an improved, more transparent, inclusive and democratic investment platform, as well as unlocking potentially billions of latent investment. This can be delivered outside the conventional boundaries of public administration and without placing undue burdens on the public coffers. This would ignite a more sustainable model of financing UK infrastructure, and unleash the social and economic potential of our communities.

Summary of Recommendations

- HM Treasury should consider how "Growth Bonds" might have potential for even more success if issued by independent community-owned enterprises and by being tied explicitly to more local, tangible and specific projects.
- HM Treasury should review fiscal incentives such as Community Investment Tax Relief, Venture Capital Trust and Enterprise Investment Scheme to ensure they create the right incentives for more sustainable long term investment.
- HM Treasury and pioneering local authorities should explore the various means at their disposal for underwrite the risk of bonds raised by Community Infrastructure Vehicles through a 'first loss', equity tranche or guarantee model.
- Local authorities should come together to explore the development of the Community Infrastructure Bond model outlined in this paper, perhaps facilitated by a representative or membership body such as the Local Government Association.
- Where public bodies continue to use PFI models, they should take on board the lessons from the likes of the Argyll and Bute model, ensuring greater transparency and channelling community engagement into investment opportunity.
- Local authorities considering models of supplementary taxation should take into account how it might be introduced in way that is fair and progressive.
- Local authorities should consider their duty to co-operate in terms of the value for money to be secured through the pooling of planning gain.
- Local authorities should explore how they may use the Community Infrastructure Levy creatively and flexibly to help contribute to the funding of infrastructure provision.
- The Core Cities group and the Mayoral cities should explore how TIF models could help underpin "City Bonds" issued in partnership with, but by bodies other than the local authority themselves, including housing associations, CDFIs or special purpose community investment vehicles.
- HM Treasury and the Department for Communities and Local Government should commission an independent study to explore the effect of TIF models on competition between local areas (e.g. raising the game for all or a race to the bottom and identifying the unintended consequences).
- One or more pioneering local authorities, cities or LEPs should establish Value Capture Vanguards to explore how property and land value capture mechanisms could support infrastructure financing with particular regard to landowners, landlord and long-term leaseholders. The Treasury and the Department of Communities and Local Government should encourage the establishment of these Value Capture Vanguards.

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