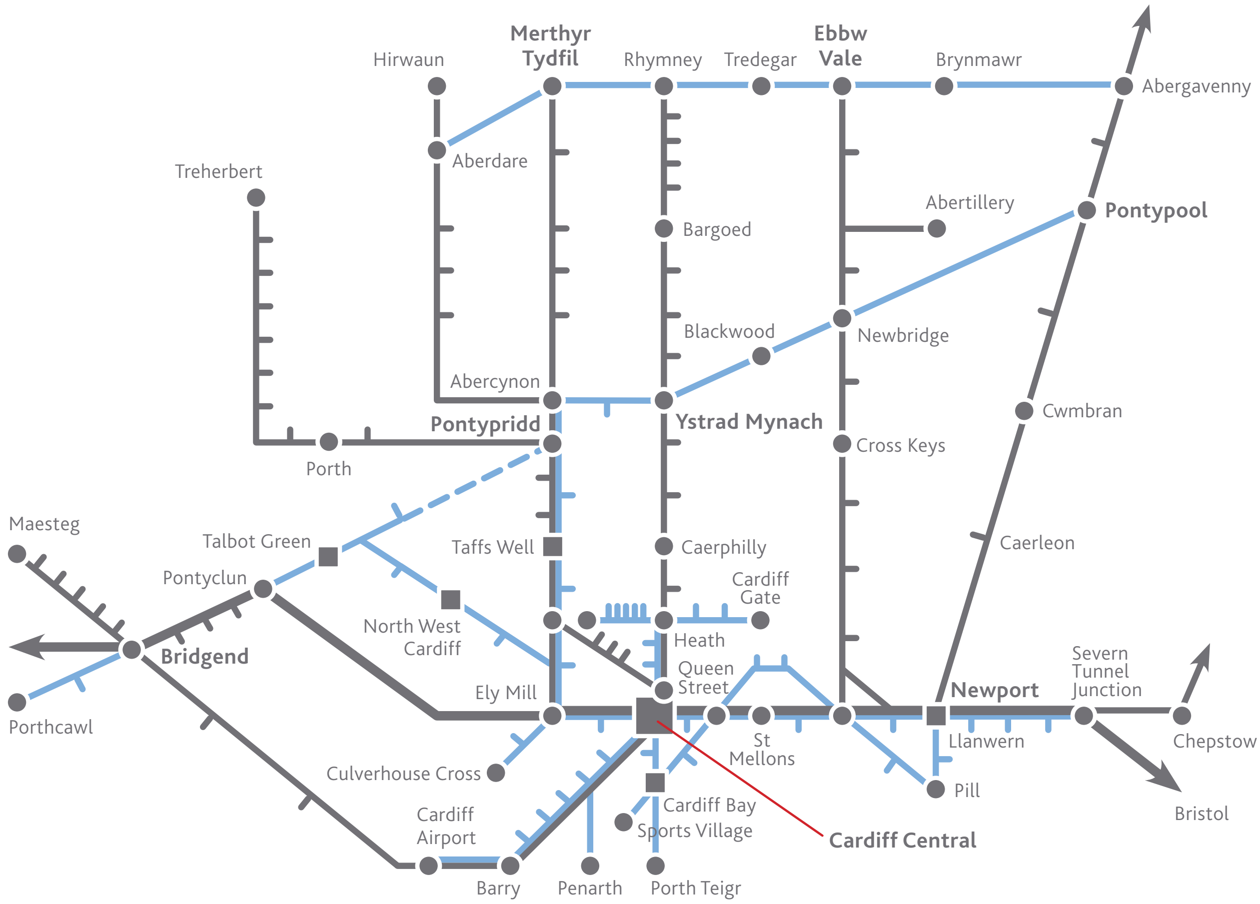
Report to the Minister for Economy, Science and Transport



A Cardiff Capital Region Metro:

Impact Study:

Funding and Financing Independent Advice

October 2013

Jones Lang LaSalle | the urbanists a powelldobson company | M&G Barry Consulting | CAPITA | steer davies gleave

Cardiff City Region Metro: Funding and Financing Independent Advice

Network Rail Financing, Land Value Capture and Other Government Funding

Report

September 2013

Prepared for:

Welsh Government

Prepared by:

Steer Davies Gleave
28-32 Upper Ground
London SE1 9PD

+44 (0)20 7910 5000
www.steerdaviesgleave.com

CONTENTS

FIGURES

TABLES

1 The Cardiff City Region Metro

1.1 This report provides an overview and assessment of the use of the Network Rail RAB, its implications for franchise economics and Welsh Government funding requirements. In addition, the report looks at other government borrowing options (eg the Public Works Loan Board) and the potential to use land value impacts as a potential financing mechanism.

Proposed Report Structure

1.2 ***Chapter 1*** will provide the report layout.

1.3 ***Chapter 2*** will be broken into three key parts each with its own focus:

- a brief synopsis of the funding options presented in the Task Force Report and Mark Barry's funding study and developing an understanding of the proposed governance structure;
- a presentation of the options for the use of Network Rail's RAB as an option to increase financing flexibility for the Welsh government in meeting the funding requirements of the Cardiff Metro scheme taking account of different policy scenarios (eg Silk Commission), consideration of timing, funding required, franchise economics and CP6/7 planning; and
- a brief analysis of options for other government sources of lending (eg the Public Works Loan Board) and an exploration of models for capturing land value uplift to help provide finance for improvements (eg TIF style arrangements) and/or development corporations.

1.4 **Chapter *3*** will, at a high level, organise the transport options along the lines of the funding options in tabular form.

2 Funding Options

2.1 Funding options are a central consideration in the delivery of the vision for the Cardiff City Region Metro. This chapter presents three key potential funding options which could be considered in taking the City Region Metro vision forward. This chapter will:

- Present a brief overview of the funding options considered to date;
- Provide background on the Network Rail RAB and its use in rail enhancement financing;
- Explore the use the tax increment financing and other land value uplift tools to help finance transport; and
- Present sources of other government funding.

Funding Options Considered to Date

2.2 The development of the vision for the Cardiff City Region Metro has been informed throughout by on-going consideration of practical funding options. Each of these options must be weighed carefully before a commitment to its use is made.

2.3 In the 2013, the South East Wales Integrated Transport Task Force delivered *Proposals for the delivery of the future public transport network* to the Minister for Economy, Science and Transport. This report included consideration of funding options which were considered further in the *Funding Study* of various undertaken by Mark Barry. The options considered are presented in summary form in Table 2.1.

TABLE 2.1 SUMMARY OF FUNDING OPTIONS[1]

Potential Funding Source	Summary
Business and non-domestic business rates	Collection of business rates in a regional fund which could be used to fund Metro scheme.
Local Authority Funding	Each local authority involved in the Metro scheme could contribute, from its own funds, towards a regional fund dedicated to the improvements.
Business Improvement Districts	Collective agreement between local businesses to invest and augment local authority funding.
Community Infrastructure Levy and S106 Funding	Separate forms in which the improvements brought by an infrastructure investment are financed by those who benefit either by agreed funding increments (eg S106) or on a taxation basis (eg CIL).
Land/Property Development	Potential for development of key sites along a transport investment corridor to capture value and help finance investment (eg Crossrail investment in property near stations).

[1] As presented in: Welsh Government Integrated Transport Task Force: Funding Study; March 2013; Mark Barry.

Potential Funding Source	Summary
Housing Associations	Finding synergies between housing investment and need for transport as a potential source of funding to ensure housing developments have adequate transport.
PPP for Metro Development	Design of a programme and structure which would allow for private sector investment in the Metro scheme alongside public sector investment.
City Deals	Through funding which has been devolved to the regional level and engagement with the private sector, funding for transport can be a component of an overall plan to unlock local economic growth. In part, the funding is secured through uplift in local business rates achieved by the investments.
Road/Car Park Charging	Road pricing and a parking levy could be used together or individually to help fund a Metro scheme.
Government Funding (DfT & WG)	Government will play an important role in funding Metro.
EU Funding	Potential to secure EU structural or other funds to provide some finance for the scheme. £1.7Bn is potentially available in Wales from 2014-2020. The funding could be split with approximately £1.36 billion in West Wales Valleys and £0.34 billion in East Wales (including Cardiff and Newport). Some scope to spend West Wales/Valleys money in East Wales if benefits accrue in West Wales Valleys (up to 20% of total).
Use of Government Assets	Use of various assets including monetisation of transport assets, use of current real property portfolio or investment by public sector pension funds.

2.4 The funding options noted in Table 2.1 and discussed further in the paper will require cooperation amongst the different political entities which make up the Cardiff Metro region. As discussed by Capita in their consideration of governance, the Metro will require “unprecedented levels of co-ordination and planning” including those involving financing. One possibility would be the creation of a Special Purpose Investment Vehicle (SPIV) during the next stage of the project, which could serve the purpose of attracting funding through a coordinated approach.

2.5 Different funding sources are also available at the European level. For the construction and upgrade of transport infrastructure lying within the identified strategic corridors, TEN-T funds as well as funds from the Connecting Europe Facility can be obtained. Regions can also receive funds that are provided by DG REGIO and the Commission. These include Cohesion funds[2], INTERREG and European Regional Development Fund (ERDF).

[2] For the 2007-2013 period the Cohesion Fund was only available to new Member States, together with Greece and Spain as their Gross National Income was less than 90% of the Community average.

2.6 Regions need to demonstrate that they have planned transport expenditure in their submission for the 2014-2020 Programming Period, although the programming documents are usually wide-reaching and allow for specific projects to be inserted during the programming period if they are within the requirements of the Programming documentation. Projects with a cost higher than €50 million are subject to appraisal and a specific decision by the European Commission. Other available funds include those available to support green urban mobility.

2.7 Lastly, the European Investment Bank could finance transport-related projects through targeted loans. Loans and are subject to a rigorous appraisal by the EIB and tend to be targeted at large transport infrastructure projects.

2.8 The use of Network Rail's RAB may benefit multiple Local Authorities in the Cardiff region and may require that each contribute a share of the cost – requiring some type of coordination and governance structure. The same will be true in implementing tools to capture land value as a source of finance. Consideration of governance options and structures, as begun by Capita, will be essential to complement and must be considered alongside funding options.

2.9 The remainder of this paper will explore in additional detail and build upon the funding options involving:

- The Network Rail RAB and its use in rail enhancement financing;
- The use the tax increment financing and other land value uplift tools to help finance transport; and
- Present sources of other government funding.

The Network Rail RAB

2.10 A regulated asset base (RAB) is a group of assets owned by a company that is subject to economic regulation. The RAB is generally established during the privatisation of an infrastructure business previously owned by the public sector with the aim of encouraging private sector investment while protecting users of the infrastructure from monopolistic exploitation.

2.11 In the case of Network Rail, the RAB represents the majority of the company assets and is largely comprised of track, bridge, signalling, station and tunnel infrastructure. The value of the RAB and the cost of its renewal and enhancement are key determinants of charges levied upon users of the rail network. Further, its value is central to determining how private investors are rewarded for their capital investments.

2.12 The UK Office of Rail Regulation (ORR) provides oversight of this asset to ensure that it is properly maintained, renewed and enhanced while ensuring both private investors and users are receiving fairs returns/prices.

The RAB in Rail Infrastructure Financing[3]

2.13 Like other regulated utilities, Network Rail has a revenue requirement which must be met to cover its costs. The RAB plays a central role in the ORR's determination of this revenue requirement.

2.14 Capital expenditure on the rail network (specifically on the RAB) which covers both renewals and enhancements (eg new infrastructure) add to the value of the RAB in a given time period. The capital expenditure, however, does not directly feed into the revenue requirement of Network Rail. Capital expenditure will influence Network Rail's financing requirement (the weighted average cost of capital, which reflects what the company need to borrow in bond and other debt markets).

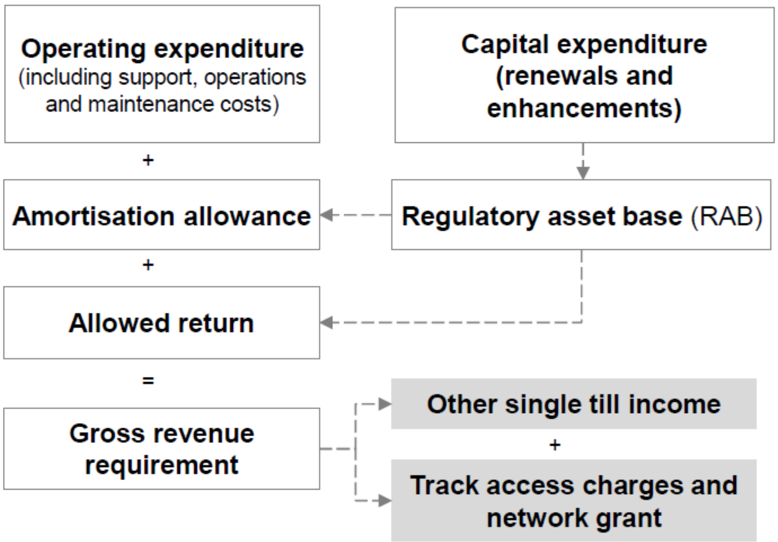
2.15 Each year, the ORR determines both the returns to which private investors (bond holders) are entitled and the amortisation (generally equal to the cost of renewing the assets over the long term) of the RAB. The cost of the finance and the amortisation add to the revenue requirement of Network Rail. Amortisation, the cost of capital and operating and maintenance expenditure are combined to determine the overall revenue requirement for a five-year control period.

2.16 Network Rail's revenue requirement is covered by three broad income categories:

- Other single till income (eg income from station retail rents, etc);
- The network grant (grant to Network Rail from central government); and
- Track access charges (which are broken down into different categories including fixed and variable charges).

2.17 The regulatory structure is discussed in the ORR's 2013 Draft Determination and presented in Figure 2.1.

FIGURE 2.1 THE RAB WITHIN THE REGULATORY FRAMEWORK[4]



[3] Additional background and information on RABs and, specifically, Network Rail's RAB, can be found at: http://www.internationaltransportforum.org/Proceedings/InfrastructureInv/McMahon.pdf

[4] Image source: http://www.rail-reg.gov.uk/pr13/PDF/pr13-draft-determination.pdf, page 52.

Criteria for Finance Using the RAB

2.18 Network Rail's RAB is regularly used as backing to raise capital, which is subsequently used for enhancements of the network. There are, however, requirements put in place by the ORR to ensure the financing of the enhancements is appropriate and affordable. The ORR's 2010 Investment Framework Guidelines[5] outline the central requirements stating that the investment must:

- Be a "reasonable requirement of government";
- "Add to the economic value of the rail network";
- Fit within Network Rail's ability to sustainably raise finance and their ability to deliver the project; and
- Be delivered efficiently, with Network Rail owning the asset once delivered.

2.19 In addition to these criteria, the ORR must also be satisfied that the projects Network Rail proposes to meet the requirements of the Department for Transport's and Transport Scotland's High Level Output Specification (HLOS) are affordable under their respective Statements of Funds Available (SOFAs).

2.20 Where the financing is not expected to be met through increased charging of franchise operators, there may be implications for the network grant to Network Rail from central government. Otherwise, the Fixed Track Access or other charges may need to increase, as discussed further below, which will have implications for franchise subsidy payments. In either case there is likely to be a need for additional government funding, as enhancement schemes, while they may be justified on economic and social grounds, can rarely be funded through additional revenue generated by higher demand or increased fares.

2.21 Note, however, that the financial framework applied by ORR for the purposes of the draft determination of Network Rail's funding for CP5, while it provides for the servicing of debt interest and long term renewal of network assets, makes no provision for the repayment of debt used to finance enhancements. In effect, Network Rail's debt is assumed to remain on its balance sheet indefinitely, although overall borrowing is regulated through the specification of a maximum debt to RAB ratio. This approach provides for greater flexibility in the funding of enhancements than would otherwise be the case, but this could change in the future depending on the regulatory stance on remuneration of debt in future periodic reviews.

Implications for Fixed, Facility, and Variable Charges[6]

2.22 As discussed above, a central component of Network Rail's revenue is that which it receives from the rail franchise operators through its charging mechanisms. The charges levied upon franchise operators are intended to be transparent and represent both the fixed and variable cost of the rail network. Each is explored in brief below:

[5] The ORR's 2010 Invements Framework Consolidated Policy & Guidelines and be found at: http://www.rail-reg.gov.uk/upload/pdf/investment_framework_guidelines_october_2010.pdf

[6] Additional background on charging can be found at: http://ec.europa.eu/transport/modes/rail/infrastructures/doc/railcalc_presentation_orr.pdf

- The **Fixed Track Access Charge** (FTAC) is designed to reflect the fixed component of costs related to the subset of assets within the RAB used by a particular rail franchise operator. Generally, the fixed charge can be defined as including the amortisation and financing cost of network assets, allocated across the franchises using the relevant part of the rail network using a defined methodology. The cost an enhancement is generally financed by Network Rail in the Control Period in which it is made and reflected in the FTAC in the following Control Period.
- The **Facility Charge** can be employed by Network Rail to recover the costs of a RAB enhancement (eg an investment in rail infrastructure) where it has been brought forward by a scheme promoter, without explicit government backing. According to ORR, "a facility charge is a charge set to recover the costs of an enhancement and is paid by the promoter of a scheme. These charges must be used for self-financing schemes, where promoters can make use of RAB financing without specific government approval…"7.
- **Variable Track Charges** are designed to represent the marginal cost incurred by Network Rail for the operation of services on a specific part of the network, including track wear and tear and electricity consumption.

__Franchise Implications__

2.23 A significant portion of a rail franchise's costs (possibly around one third) are composed of the charges levied by Network Rail. Where a network enhancement is built to expand or improve the rail infrastructure in an area it can be expected that the costs will ultimately be passed through to franchise operators benefitting from the improvement.

2.24 The franchise operators will, in an attempt to maximise their profits, pass these costs on at the time of the franchise bid. In a simplified presentation, it could be expected that the rail franchise would undertake to do one of or some combination of the following:

- Pass the increased charges on to passengers;
- Increase the amount of subsidy it requires from government to operate the franchise (if a subsidy is involved); and/or
- Reduce the premium they pay to the government for the right to operate the service.

2.25 In particular, the last two may implicate Welsh Government funding for rail services and/or the central government funding either through changes in franchise support or the network grant.

2.26 Note that where track access charges increase following a regulatory determination, except in a few limited cases, the increase is passed on to government through an adjustment to the franchise payment. In principle, the adjustment is determined under the provisions of Schedule 9 of the Franchise Agreement by changing the values of track access charges in financial model submitted with the winning financial bid. In practice, the adjustment is usually

[7] Source: http://www.rail-reg.gov.uk/upload/pdf/investment_framework_guidelines_october_2010.pdf, paragraph 73.

subject to negotiation, although the impact of a simple change in FTAC is relatively simple to establish.

Can the RAB be used for Metro?

2.27 Where the Metro scheme proposals are to make specific enhancements to Network Rail assets that are part of the RAB, financing options may be available. Enhancements to Network Rail's RAB, which are financed by Network Rail, will have implications for the amount of revenue required by a franchise (either in subsidy or ticket sales), as note above.

2.28 In a case where the specification of rail services and their funding remains with the UK Government, RAB financing is likely to broadly lead to one of two scenarios for the Welsh Government:

- Ensuring appropriate support from the UK Government and the UK Department for Transport through network grant; and/or
- Short-term facility charges for franchise operators and potential longer-term increase in FTAC along enhanced routes, also funded through public subsidy.

2.29 Where increases in charges are levied on franchise operators and are not met by increased UK Government support, it may be necessary to agree how to meet funding requirements with the franchise operators.

Devolution of powers in relation to the rail network

2.30 Where powers for taxation, spending, and rail specification are devolved to the Welsh Government (in all or in some mix) there is likely to be additional flexibility to secure enhancements financed through the Network Rail RAB. If, in addition, the Welsh Government were able to specify and fund rail services, it could be expected to prepare a separate HLOS for Wales within the funding constraints set by a Welsh SOFA, following the precedent set by Scotland.

2.31 A separate Welsh HLOS would require the calculation of a RAB corresponding to the railway network in Wales. The calculation would probably be based on the methodology applied to determine the Scottish RAB in 2005, involving cataloguing of the various track, signalling, station and other assets and apportionment of values according to metrics such as track-km. Scotland's RAB is forecast to be £4.7 billion at the start of CP5, some 10% of the total RAB value for Great Britain. A simple comparison of track miles in Wales and Scotland suggests that the Welsh RAB might be around £2.5 billion, although application of the full methodology could yield a significantly different result.

2.32 The opening value of the Welsh RAB would be rolled forward in each control period, based on the addition of capital expenditure (renewals and enhancements) undertaken and a reduction of amortisation (reflecting steady-state renewals over the long term). The revenue requirement arising from the operation, maintenance and renewal of the network in Wales would then be determined according to:

- The allowed rate of return applied to the Welsh RAB (probably equivalent to the rate of return calculated for the national network as a whole);
- The estimated cost of renewing the Welsh network over the long term;

- An estimate of efficient operating and maintenance expenditure on the Welsh network over the relevant control period.

2.33 The extent to which RAB financing might support Metro and other rail-based investment would depend on the level of the SOFA, which could be expected to be the subject of a negotiated settlement as part of a broader agreement on the devolution of powers. Once the SOFA was determined, the Welsh Government and other stakeholders would need to work closely with Network Rail to prepare an HLOS that the ORR would judge to be affordable.

2.34 As already noted, the approach that ORR has taken to debt remuneration for the purposes of the CP5 determination makes no provision for the repayment of debt incurred to finance renewals. Any change in the approach taken in future periodic reviews would have implications for the availability of funding for enhancements in Wales as on the rest of the national rail network.

Capturing Uplifts in Land Values

2.35 The value of privately held land often increases as a result of public investment in infrastructure, for example a new transport scheme. Any uplift in land values is likely to translate into higher rental values for residential as well as commercial property.

2.36 Evidence from a range of studies supports the view that transport schemes have a positive impact on land values. For instance, rail stations have the potential to raise land values in the surrounding area. Evidence suggests that moving 250 metres closer to a station has the potential to increase residential property values by around 2.4% and commercial property values by 0.1%[8]. Evidence also suggests that the impact on residential values is smaller than on commercial values, but materialises over a wider geographical area.

2.37 Further evidence on rapid transit is available from North America. Based on average values for the US and benchmarks from the Government of Canada, a bus rapid transit scheme would have a modest positive impact, creating a 2-4% premium on residential and office space and 1-2% premium on retail property values within a 400-meter radius of stations[9]. The work recognises that a light rail scheme has the potential to lead to higher premiums, partly because of lower negative externalities such as pollution and of lower susceptibility to local traffic conditions. While transport investment appears to play an important role in promoting regeneration, other attributes such as urban realm improvements will clearly enhance its impacts.

2.38 The idea that these "windfall gains" in land values should in some way be captured by the public and used to finance the investment from which they arise constitutes the rationale for establishing land-value capture methods. The implementation of these methods represent a potential, untapped source of new funding for transport schemes in Wales.

[8] Steer Davies Gleave (2011), "The value of station investment", Research for Network Rail

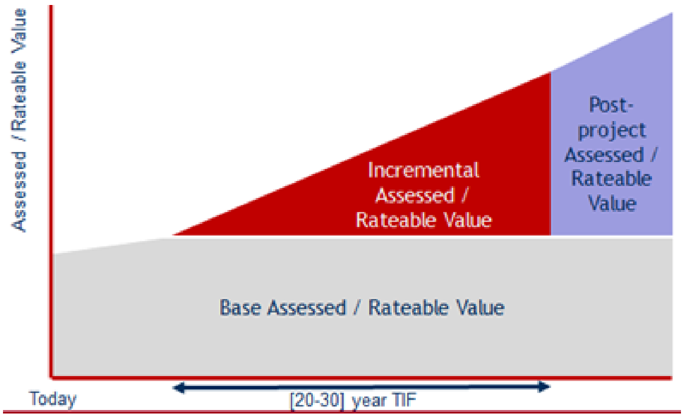
[9] Steer Davies Gleave (2008), "VIVA Benefits Case", Research for Metrolinx

Capturing the uplift: TIF-style mechanisms

2.39 A widespread mechanism among local authorities in the US is Tax Incremental Financing (TIF), which aims to ring-fence the increment in local property taxes attributable to infrastructure investment, and collect it over time to provide a revenue stream that can service the long-term borrowing raised to finance the investment.

2.40 The key underlying concept behind the TIF is additionality. Local governments need to define the investment type and the area that will be affected. By forecasting the impacts of the investment, the authorities check whether there are any additional benefits beyond a base scenario, as shown in Figure 2.2. Where there is some additionality, the development leads to higher tax revenues as firms and individuals relocate to the area and property values rise. Local authorities can also choose whether to ring-fence increases in residential property taxes only, commercial rates only, or both.

FIGURE 2.2 CAPTURING ADDITIONAL LAND VALUE



2.41 The introduction of TIF-style mechanisms in the UK was first advocated by Lord Rogers in his manifesto “Towards a Strong Urban Renaissance” (2005), as an alternative funding source for large capital investment projects. In 2010, Deputy PM pushed for the inclusion of new funding schemes in the coalition government agreement. Following consultation by the Department for Communities and Local Government in 2011, TIF is now within the powers of the Secretary of State and the Prudential Code for borrowing requirements.

2.42 Legislation was also passed by the Scottish Parliament in December 2010 to approve the use of TIF. National guidelines specify that the use of TIF would be normally based on a ‘but for’ test (i.e. establishing a counterfactual that regeneration would not occur in the timeframes which TIF would enable). The likelihood of additional revenues also need to be demonstrated at the onset of a project. Any TIF proposals should be supported by a business case. Following a call for TIF projects in June 2011, the government received 16 applications (3 were chosen to progress to full Business Case).

Why TIF is different from current planning mechanisms

2.43 The UK development control system has traditionally allowed local authorities to require developers to mitigate negative, site-specific impacts by imposing obligations to fund infrastructure provision and to deliver affordable housing. To this end, S106 was introduced in the Town and Country Planning Act 1990 and has since then been widely used by local authorities in negotiations with developers; before 2008, 75% of residential developments of more than 10 units were subject to S106 Agreements[10].

2.44 However, in 2011, the Community Infrastructure Levy was introduced, with the aim to simplify the system of planning obligations by allowing local authorities to set upfront levy rates in consultation with local communities and developers. This system is designed to avoid lengthy negotiations and provide more certainty to developers about their contributions. In Wales, the county and borough councils, and the national park authorities, have the power to charge the levy.

2.45 In comparison to these existing mechanisms, TIF-style schemes present several differences, which are summarised in Table 2.2 below. TIF is designed so as to raise funds for larger-scale transport projects and secure a revenue stream in the long-term. However, there are a number of administrative procedures related to TIF which require constant monitoring and assessment by an expert team.

TABLE 2.2 COMPARISON OF S106, CIL AND TIF

	Funding potential	Target group & timeline	Administrative burden
S106	Smaller, site-specific infrastructure unless greater coordination between LAs achieved	Developers contribute, following negotiation on amounts and rateability	Requires negotiation between LAs and developers, which may delay construction
CIL	Smaller, site-specific infrastructure unless greater coordination between LAs achieved	Developers contribute, based on the pre-established levy rates	Uncertainty over evidence to justify local rates and responsibility for collecting the levy
TIF	Larger cross-boundary projects, provided local authority has borrowing capacity	Property owners and tenants contribute, in the form of local property taxes (e.g. council tax)	Incremental land values difficult to calculate. Need to asses values regularly. Debt management throughout.

2.46 Crucially, TIF does not presuppose the presence of new development; it can be devised to finance transport investment for projects running through existing built-up areas as well. In this case, it is necessary to clearly identify the area that is expected to benefit from the transport scheme – for example by defining a radius around the new stations. A TIF area does not need to be a continuous corridor, but rather it can be formed of different zones identified a long an investment area.

[10] RICS Research (2012), Capturing Planning Gain – The Transition from Section 106 to the CIL

Funding scenarios for Wales, with and without TIF

2.47 The introduction of TIF-style schemes in Wales could provide an alternative source of funding for infrastructure investment, including for transport projects in the Cardiff City Region. However legal and institutional capabilities (tax-raising powers and borrowing powers primarily) need to be in place for any TIF schemes to be implemented.

2.48 With respect to tax powers, the Welsh government sets the level of non-domestic rates and influences rates of council tax. Control over these local property taxes is a prerequisite for the development of TIF-like schemes. This is one of the key recommendations put forward in the 'Business Rate Wales Review'[11], namely "enabling Local Authorities to retain a proportion of the income they generate from business rates". With respect to borrowing, at present the Welsh Government can only borrow from HM Treasury to manage its cash flow. This represents a potential obstacle to raising funds for capital investment.

2.49 The first report by the Commission on Devolution in Wales (November 2012) has put forward several recommendations on Wales's financial powers, including on taxation and borrowing. The Commission's conclusions on borrowing are of particular relevance for the introduction of TIF in Wales:

"We recommend that Welsh Ministers should be given an additional power to borrow to increase capital investment above the Welsh Government DEL budget. There should be an overall limit to such borrowing, at least proportionate to that in Scotland, whilst taking into consideration the relative lack of exposure to PFI in Wales"

Commission on Devolution in Wales: "Empowerment and Responsibility: Financial Powers to Strengthen Wales" – Executive Summary, p.5 (November 2012)

2.50 Provided that future institutional reforms allow Welsh ministers to issue project bonds for capital investment, a further layer of "devolution" would then be required to ensure that TIF-style mechanisms can be smoothly implemented at the sub-national and/or regional level. That is, for TIF to be successful, local authorities need to be able to raise revenues from property taxes to service long-term borrowing.

2.51 Should this be made possible, unitary authorities in Wales could come together to promote large-scale transport projects using TIF in different ways:

- unitary authorities could be given powers to create an inter-authority body, borrow collectively and pool together a share of incremental tax revenues for repayment, or;
- the Welsh Government could underwrite borrowing on behalf of several unitary authorities and administer a given share of tax revenues for repayment.

2.52 Both options could rely on loans from the UK Public Works Loan Board in order to achieve their funding targets, as described in the section below.

2.53 Under the scenario of a reformed institutional framework, it is possible to envisage that TIF and planning obligations would be implemented as complementary

[11] Business Rates Task and Finish Group (2012), Business Rate Wales Review: Incentivising Growth

measures in regeneration efforts. However in the absence of further devolution, more traditional development obligations will represent the most effective way to capture land value premiums.

2.54 As outlined in the March 2013 funding study, the Welsh Government has issued guidelines for the preparation of charging schedules as part of the CIL initiative. These, in conjunction with the revised Regulation 123 of the CIL Regulations, will determine the CIL rates ahead of its national implementation in April 2014.

2.55 The total amount available for Metro from the CIL will depend on the combination of levy levels, the amount of new construction and the proportion of revenue dedicated to transport. The first two factors are dependent upon economic/political considerations and the housing market respectively. Strategic developments which could provide momentum for land-value capture mechanisms include the existing Cardiff Bay area as well as the forthcoming urban expansion around the North-west Cardiff corridor.

2.56 The revenue aspect will be a key challenge for the consortium. It will be important for a large share of CIL contributions to be dedicated to the Metro and it will be crucial that local authorities are ready to work together in a strategic manner so as to maximise the impact of these funds. The potential re-organisation of Local Authorities in Wales, following the next Welsh Assembly elections, might be a catalyst for a more joint-up approach if the number of Authorities across SE Wales is eventually reduced.

2.57 Integrated planning is also going to be necessary to ensure that new, large developments are incentivised to locate along the proposed transport-improvement corridors. The Mayoral CIL implemented in London since 2012 to fund Crossrail represents an example of potential larger-scale applications.

2.58 Planning obligations (as secured through Section 106 agreements) will still exist after 2014, but will be more limited in how they can be used. Once CIL is adopted authorities will not be able to pool funding from more than five planning obligations for infrastructure that can be funded via a CIL. These provisions reduce the scope for S106 funding the Metro, and highlight the importance of CIL as the most reliable land value capture option over the next few years.

Other Government Funding Sources and Initiatives

The UK Public Works Loan Board

2.59 The UK Public Works Loan Board has, under Section 3 (11) and Schedule 4 of the 1968 Act, the power "to make loans to any local authority in Great Britain for any purpose for which the authority has power to borrow and to certain other authorities and persons for limited purposes".

2.60 Since October 2010 local authorities across the UK have borrowed on average £228m a month from the PWLB[12], at significantly lower levels than those pre-recession. However, the PWLB remains the main source of borrowing and has continued to fund some 76-77% of total borrowing.

[12] PWLB monthly lending data

2.61 The PWLB's interest rates are based on the rates for the National Loans Fund and are agreed with HM Treasury. They include a margin to ensure that the PWLB does not lend at rates lower than those at which the HM Government could notionally borrow by issuing gilts. Fixed PWLB rates ranged from around 1.3% on 1-year maturity bonds to just over 4% for 25-year maturity bonds in 2012. Only a minority of loans are made on a variable-term basis to local authorities.

2.62 The analysis of amounts advanced by type of borrower from the PWLB Report 2011-2012 reveals that Welsh local authorities received 0.4% of total funding (authorities in Scotland borrowed 4.8% of the total) – the vast majority of funds went to non-metropolitan district councils in England.

2.63 While these figures may reflect the limited scale of recent capital investment in Wales, they might also indicate that a more proactive approach is needed by Welsh authorities to tap into this major source of central government funding.

Development Corporations

2.64 Another initiative which would require an active public role to be achieved relates to the potential establishment of special planning bodies such as development corporations (DCs). DCs are granted statutory planning powers in relation to land acquisitions, planning consent and obligations, funding, etc.

2.65 These bodies act as a vehicle to speed up planning processes and promote common regeneration efforts across traditional administrative boundaries and across areas of investment. In Wales, the presence of 22 unitary authorities and 3 national park authorities already provides a joined-up approach to planning across different areas of investment.

2.66 However, given the cross-boundary nature of large-scale transport investment, the 10 authorities of SE Wales might be able to streamline the planning process and plan for a Metro-style integrated transit investment more effectively under the coordination of a DC-type body. In addition, special planning powers could simplify land acquisition and development processes by public bodies, with the potential to buy land at lower prices, develop it and subsequently put it back on the market for a higher value.

2.67 Against these potential benefits, it must be recognised that the effectiveness of DC-type bodies depends on other factors outside the planning process, including the demand for housing and commercial spaces as well as the presence of significant tax breaks to attract investment. Both factors were key to the successful regeneration of the London Docklands. Furthermore, it can be difficult to secure support from local authorities as they are bound to lose some key powers under a DC-type arrangement.

2.68 It should also be noted that development corporations do not offer the potential for complementarity with TIF-style mechanisms as much as planning tools such as the CIL do. The key differences between DCs and TIF are summarised in Table 2.3.

TABLE 2.3 COMPARISON OF DEVELOPMENT CORPORATIONS AND TIF

	Funding potential	Institutional capabilities needed	Certainty of outcomes

Development Corporations	Not a direct funding tool – planning and incentive measures to attract private investment from developers	Special planning powers in relation to land acquisition and tax breaks. Coordination between LAs.	Dependent upon attractiveness of sites, developers' finance and latent demand for commercial and residential space
TIF	Potential to fund large cross-boundary transport projects given uplift in property values	Local authorities must be able to retain and manage tax rates, and have borrowing capacity	Dependent upon effective value uplift and ability to manage debt repayments over time

2.69 While DCs and TIF are not complementary, a sequential approach might be envisaged whereby DCs are a catalyst for construction in the first place, and, at a later stage, a TIF mechanism would be devised as a tool for transport funding.

2.70 In the context of South East Wales, we understand there may be a medium-term appetite for a re-organisation of Welsh Local Authorities. An alignment of government funding, oversight and management could potentially remove some barriers to DCs or even the establishment of a PTE, although the specific circumstances of a re-organisation would determine the ultimate outcome.

3 Funding Options Alignment

TABLE 3.1 FUNDING OPTIONS AND TRANSPORT IMPROVEMENTS

Potential Funding Source	Improvements to Rail Network	Tram and Tram Train (outside rail network)	Bus Rapid Transit	Bus	Road Improvements	Cycling and Walking
Strategic Funding						
EU Funding (including TEN-T and structural funding)	✓ Provided it is a strategic corridor (TEN-T)	✓	✓	✓	✓	✓
Government Funding (DfT & WG)	✓	✓	✓	✓	✓	✓
Use of Government Assets (NR RAB)	✓Specific to assets included in the RAB and in consultation with NR					Potential to use for some station improvements.
Local Funding						
Business and non-domestic business rates	✓ In consultation/ with agreement of NR	✓	✓	✓	✓	✓
Local Authority Funding	✓ In consultation/ with agreement of NR	✓	✓	✓	✓	✓

Potential Funding Source	Improvements to Rail Network	Tram and Tram Train (outside rail network)	Bus Rapid Transit	Bus	Road Improvements	Cycling and Walking
Business Improvement Districts	✓ In consultation/ with agreement of NR	✓	✓	✓ May need consideration that assets could be easily moved	✓	✓
Community Infrastructure Levy and S106 Funding	In a devolved scenario, potential for WG to raise revenue through improved infrastructure and direct back in TOC subsidy	✓	✓	✓May need consideration that assets could be easily moved	✓	✓
Land/Property Development	Potential to raise revenue through increased development which could be used to finance improvement w/ agreement of NR	✓	✓	✓May need consideration that assets could be easily moved	✓	✓
Housing Associations		✓	✓	✓May need consideration that assets could be easily moved	✓	✓

Potential Funding Source	Improvements to Rail Network	Tram and Tram Train (outside rail network)	Bus Rapid Transit	Bus	Road Improvements	Cycling and Walking
PPP for Metro Development		✓	✓	✓	✓	✓
City Deals	✓	✓	✓	✓	✓	✓
Road/Car Park Charging	Potential to use station car park charging for station improvements through cross subsidy	Potential for car park charging on lots owned by network to provide cross subsidy	✓	✓	✓	✓

CONTROL SHEET

Project/Proposal Name	Cardiff City Region Metro: Funding and Financing Independent Advice
Document Title	Network Rail Financing, Land Value Capture and Other Government Funding
Client Contract/Project No.	Click here to enter text.
SDG Project/Proposal No.	22602502

ISSUE HISTORY

Issue No.	Date	Details
Final 100913	19 September 2013	Final draft

REVIEW

Originator	Christopher Busch	
Other Contributors	Simon Ellis, Lorenzo Casullo	
Review by:	Print	Simon Ellis
	Sign	S. C. Ellis

DISTRIBUTION

Client:	Welsh Government
Steer Davies Gleave:	File 22602502

Supporting documents:

- Appendices to Main Report
- Metro Interventions Appraisal Report
- Metro Modal Study
- Metro Spatial Map
- Regeneration and The Metro
- Station Design Guidelines (Ebbw Vale)
- Metro Economic Impacts

Study led by Mark Barry of M&G Barry Consulting and included Capita, Powell Dobson Urbanists, Jones Lang LaSalle and Steer Davies Gleave

www.metroconsortium.co.uk