

RSA Winter Conference 2014 'Sustainable Recovery? Rebalancing, Growth, and the Space Economy"

Is Tax Increment Financing the most effective tool to support urban investment? The case of London Northern Line Extension

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London, November 27-28, 2014

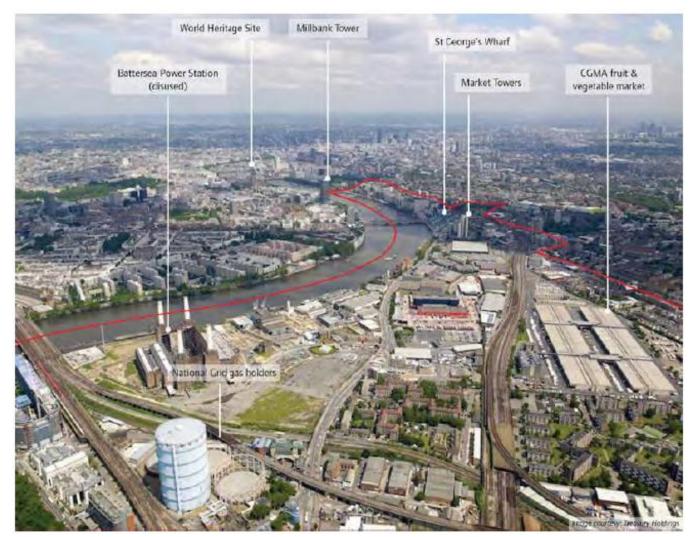
Outline

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Introduction

- The proposed extension of the Northern Line (NLE) of the London Underground is one of the major infrastructure projects currently planned to be constructed in Britain.
- The NLE is expected to improve transport links and public spaces and support the transformation of Vauxhall, Nine Elms and Battersea (VNEB), a designated regeneration area on the South Bank.

Introduction



Source: (GLA) (2012), "Vauxhall Nine Elms Battersea: Opportunity Area Planning Framework"

Research objectives

- In this context, the objective of this paper is to evaluate the effectiveness of the proposed Tax Increment Financing (TIF) mechanism as a funding source for the NLE.
- The potential consequences of TIF implementation are examined using several suitable criteria and sub-criteria.

Tax Increment Financing (1)

- TIF belongs to the wide family of Value Capture Financing (VCF) mechanisms
- It is an economic development incentive package which has been implemented widely in the USA, where it has its origins, with successful as well as controversial results
- Attempting to remove physical blight, its implementation includes the creation of a geographical district, where the tax base (i.e. the property values) is considered "frozen" for a period of time, usually 10 to 25 years, under the assumption that the area would not develop but for the planned intervention ("but for" requirement)

Tax Increment Financing (2)

- As investments begin to take place within the TIF area, property values increase, and so is the tax revenue
- The new property tax minus the tax on the frozen property values (tax increment) is collected by the TIF authority and used either to repay the capital costs of the investments or to support further development
- TIF is directed towards property owners and its implementation starts before the planned improvement

Tax Increment Financing (3)

- A more skeptical approach suggests that TIF might trigger favoritism between governments and certain large developers, that a wide portion of the tax base is exempted from general taxation for a noteworthy period of time and that the criteria used to characterize an area as "blighted" are not always objective
- The main experience from the implementation of VCF in London so far comes from the Business Rate Supplement (BRS), a betterment tax currently used by GLA to finance part of the Crossrail Project's costs. Introduced in 2010, it is applied to all non-domestic properties with a rateable value above £55.000, with a 2%, flat rate

Tax Increment Financing (4)

- Until recently, there had been no framework in place at a UK Government level for Local Councils which would like to use TIF to fund projects
- The English Government introduced TIF schemes, founded on the Business Rates Retention Scheme of 2013-14. Under these schemes, local authorities may borrow for infrastructure projects, against the future growth in business rate receipts which will result from the projects.
- According to the Local Government Finance Act 2012: "The Non-Domestic Rating (Designated Areas) Regulations 2013 and 2014 include several dozen areas, many of which are Enterprise Zones, in which the local authority will retain 100% of business rates growth for the next 25 years"

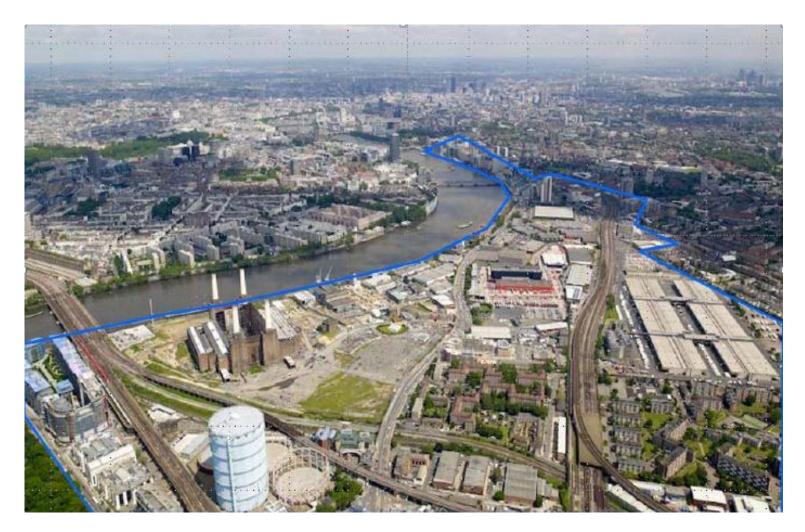
Case analysis (1)

- The NLE Project includes an extension of the existing Northern line in south-eastern London from the Kennington loop to a new terminus station to Battersea Power Station (BPS) via an intermediate station located in the Nine Elms area
- Construction start: 2015
- Line opening: end of 2019
- BPS area is being redesigned to become one of the largest retail, leisure and cultural complexes in central London, with 40 million visits per year
- Up to 25,000 jobs and 16,000 new homes will be created

Case analysis (2) NLE map

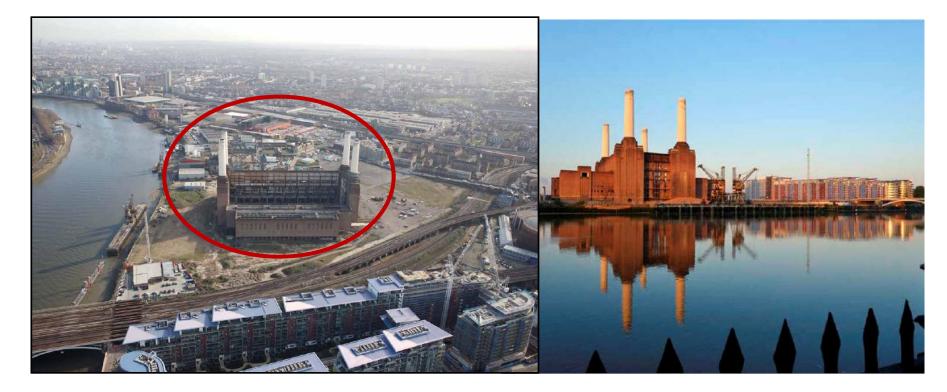


Case analysis (3) VNEB OA



Source: Ware (2012)

Case analysis (4) Battersea Power Station (BPS)



Source: a. (GLA) (2012), "Vauxhall Nine Elms Battersea: Opportunity Area Planning Framework" b. Volterra (2009)

Case analysis (5)

- The NLE scheme is estimated to cost £868m (2012/13 prices), allowing for 22% contingency (£998.9m inflation included)
- According to the Finance and Policy Committee of Transport for London (August 2014), the NLE will be publicly financed but externally funded
- The up-front costs of constructions will be paid by an up to £1bn dept raised by the public sector, while the private sector will be responsible of repaying the dept using a dual form:
- 1. By the use of a special tariff imposed on developers for the new development that will occur within the VNEB OA, under the Section 106 and CIL concept
- 2. By the incremental business rates which are going to be generated in a new enterprise zone in Nine Elms, which will operate for at least 25 years under a TIF model

Case analysis (6)

- Carter Jonas (2014) estimated the positive impact of NLE in terms of office capital value between £375 and £470m and of residential values between £4.7 and £6.4b, above baseline value
- In combination with other major transportation future projects in London, such as Crossrail 2, NLE will definitely have a vital role in shaping the London economic geography for the years to come

Case analysis (7)

Public Transport Accessibility Level (PTAL) before and after NLE



Source: (GLA) (2012), "Vauxhall Nine Elms Battersea: Opportunity Area Planning Framework"



Evaluation criteria used so far

Kemp and Mollard (2013) consider that all value capture mechanisms should be assessed against four criteria: economic efficiency, incentives, equity and transparency.

lacono et al. (2009) evaluate TIF for transportation infrastructure against efficiency, equity, sustainability and feasibility criteria Mathur (2014) evaluates several case studies of TIF implementation in the USA, using the following five main criteria: enabling environment, institutional capacity, stakeholder support, revenue yield stability and growth and horizontal and vertical equity. The latter is believed to be of high importance for Litman (2014) as well.

In addition to that, he focuses on other evaluation criteria such as potential revenue, predictability and stability, travel impacts, strategic development objectives, public acceptance, ease of implementation etc.

NLE TIF Evaluation Framework (1)

- In this context, the evaluation framework for the assessment of TIF as a financial instrument for the NLE was formed based on criteria widely used in the existing relevant literature, after making the necessary adaptations, to best fit this specific case study.
- The differentiation in colour indicates the result of evaluation for each specific criterion. Green colour corresponds to positive evaluation, while red shows negative assessment. Yellow indicates that there is the possibility for either positive or negative outcome.

Main criteria used:

Economic efficiency
Equity
Sustainability
Feasibility

NLE TIF Evaluation Framework (2)

Evaluation Criteria	NLE Tax Increment Financing
Economic Efficiency	
Estimated Revenue yield	Wider Economic Benefits of £1.6 to £7.9b for the UK economy and a raise in capital values of >60% for the office sector and >70%, for the residential one around the new metro stations, assuming that a coherent supportive planning policy will be applied (Volterra, 2011; Carter Jonas, 2014).
Growth potential	Average residential unit sale price change (2009 – 2014): +78.3% in Lambeth and +71.6% in Wandsworth. Respectively, for 2013-2014: +28.9% and +24.7% (Land Registry UK, 2014).

NLE TIF Evaluation Framework (3)

Evaluation Criteria	NLE Tax Increment Financing
Equity	
Horizontal and Vertical equity	TIF is generally not based on the ability to pay principle which can cause inequalities in the distribution of tax burden among income groups of the TIF district (Martinez, 2010).
Poverty indicators: Unemployment rate, Gross Annual Pay, Overall benefi	Six poverty indicators were selected in order to examine the equity criterion for Lambeth and Wandsworth in comparison with London average (London's poverty profile website, 2014, GLA, 2014).
polarization, Low paid jobs by place of residence and	Mixed results: cannot be characterised as deprived area but neither can its residents be characterised as privileged. The implementation of the tax could possibly have a negative impact on equity.

NLE TIF Evaluation Framework (4)

Evaluation Criteria	NLE Tax Increment Financing
Sustainability	
Stability	The range of the tax base can be used as an indicator for the volatility of revenue of the plan, and thus, its general stability. In this case, the tax base is rather limited.
Planduration	Ambiguity about the exact duration of the plan. It is described as "at least 25 years". Not clear what will happen afterwards, in case the dept is not repaid until then.
Predictability	The revenue estimation is subject to potential statistical forecasting bias and errors. Revenue possibly lower than estimated - depending on the unsure economic climate.
Strategic development	
objectives	In line with the strategic objectives of the London Plan (GLA, 2011).
Incentives	TIF is an Accessibility Increment Contribution (AIC) method, the basic notion of which is to provide with incentives for economic development to low accessibility areas (Medda, 2012). The VNEB OA is a representative example of such case.

NLE TIF Evaluation Framework (5)

Evaluation Criteria	NLE Tax Increment Financing
Feasibility	
Enabling legal environment	Business Rates Retention Scheme of 2013-14 introduces TIF (Sandford, 2014).
Stakeholdersupport	NLE has received significant support from the Local Councils and the results of the continuous consultation and of TIF introduction have been reported as positive so far.
Public acceptance	Residents of TIF districts do not experience an increase on tax rates while benefiting from the renewal process, so generally TIF receives a high level of public acceptance.
Administrative complexity	Need of establishing a special authority, thus requires human and financial resources (Mathur, 2014). High administrative complexity due to lack of previous experience in England.
Transparency	Specific accounts of projected TIF revenue not available online. Lack of transparency in the calculation procedure (possibly data available from GLA on request?)

Conclusions – Perspectives (1)

- TIF emerges as an effective tool to support urban investment and enhance growth.
- The case study analysis and evaluation has shown that its advantages appear to exceed the associated drawbacks, but it should be applied wisely due to the lack of experience in the field of TIF implementation in England
- If it is proved successful, the NLE TIF could be used as a pilot for future application of the method elsewhere in London and across the country.

Conclusions – Perspectives (2)

- The research presented herein is planned to continue by comparing the case study through a meta-analysis with other TIF applications worldwide.
- In order to further analyse the application of NLE's TIF, Multicriteria Decision Analysis Models are going to be used to compare it with potential alternatives such as a hypothetical NLE BRS scenario of the same duration.
- This will allow the in depth examination of the geographical impact of NLE investment, towards the principles of sustainable and smart city development.

Acknowledgment

Anastasia Roukouni is grateful for the Fellowship of Excellence (Siemens Program) awarded by the State Scholarships Foundation (IKY) in the framework of the Hellenic Republic – Siemens Settlement Agreement, for her PhD studies, in the context of which this research has been conducted.

Thank you for your attention!



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