AGENDA ITEM 6

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

27TH JULY 2017

REPORT OF THE MANAGING DIRECTOR

PORTFOLIO: INVESTMENT AND BUSINESS GROWTH

EXERCISE OF COMBINED AUTHORITY BORROWING POWERS – DISCUSSION PAPER

SUMMARY

The purpose of this paper is to update Cabinet on progress in establishing the Combined Authority's borrowing powers, and the principles to be established for use of those powers to deliver on our ambitious plans for investment.

RECOMMENDATIONS

It is recommended that the Combined Authority Cabinet:

i. Note and comment on this paper;
ii. Agree in principle to the Combined Authority receiving borrowing powers, with maximum local flexibility subject to the application of the Prudential Code.

DETAIL

1. In the Autumn Statement 2016 the Government stated that it plans to give mayoral combined authorities powers to borrow for their new functions, which will allow them to invest in economically productive infrastructure, subject to agreeing a borrowing cap with HM Treasury.

2. Currently, Combined Authorities only have powers to borrow for their transport functions, which is of limited relevance to the Tees Valley since we do not have responsibilities for the delivery of transport services. The primary legislation to extend borrowing powers to all the Combined Authorities' functions exists already through the Devolution Act 2016, but an additional Order is required to "switch on" these powers. We expect borrowing powers to be subject to the Prudential Code, which applies to all Local Authority borrowing. We will only be

able to borrow where we are able to generate a return from investment, or can effectively assign funding to fully fund the borrowing cost. Whilst other sources are possible, the most cost effective source of funding is likely to be the Public Works Loan Board.

3. The ambitious but prudent exploitation of the Combined Authority's borrowing powers could generate additional funds for investment in accordance with our Investment Plan, and significantly increase the potential to generate additional economic development. This will enable the Combined Authority to complement the borrowing that can be done by our partner Local Authorities, and add significant value through our independent investment and commercial activity, particularly to de-risk projects and bring them forward faster than would otherwise be the case.

4. The scale at which this will be possible depends on the project pipeline generating sufficiently strong business cases to satisfy the requirements of the prudential code, the overall risk appetite of the Authority, and any restrictions placed on the borrowing powers by national government. As a body created by the Combined Authority, new borrowing powers could also be exploited by (or on behalf of) the South Tees Development Corporation, since the STDC will not have powers to borrow independently.

5. Our agreed Investment Plan sets out how the Combined Authority would approach the utilisation of new powers to borrow. In principle, the Authority could accelerate investment by using some of our future allocation of funding agreed through our devolution deal (£15m per year for 30 years), to fund the financing costs of borrowing to fund investment. This would enable us to "front load" our investment, to bring forward and de-risk projects earlier than would otherwise be the case.

6. As a guide, if we were to assign half of our devolution deal funds to finance borrowing (£7.5m a year for 25 years), this could add an additional £120m to our Investment Plan within the 2017-21 period. We are however restricted through the "gateway" process, through which future allocations of the £15m annual allocation need to be approved by government in 5-yearly tranches, following an evaluation of the impact of previous allocations. The means that an element of risk is attached to future access to devolution funding, which would need to be taken into account when committing borrowing costs against this particular income source. To mitigate this risk, we are exploring with government officials whether an exemption from the gateway process might be possible in certain circumstances.

7. A further opportunity arises from our Enterprise Zones ("EZs"). Because we can retain business rates for a 25 year period (from 2013/14), we can prioritise our investment into our EZ sites by borrowing to invest in infrastructure or deals that unlock these sites for new development. The new businesses attracted will pay business rates which can be used to pay off the original loan. For instance, a site which generates an extra £1m in business rate income could justify a £17m upfront investment.

8. Other opportunities to finance borrowing may arise from new revenue sources (for example through the STDC), through securing a stake in new developments, or as the Combined Authority develops its housing responsibilities.

Next Steps

9. Further work will continue in collaboration with the Finance Directors of the five councils, to developing the Authority's approach to exercising new borrowing powers as and when they are granted.

10. The immediate task is to ensure the statutory arrangements are put in place, and we are engaging with the Treasury and DCLG to establish the necessary legislation. We are also putting the case for a high (or no) absolutely restriction on borrowing, and to ensure that the gateway process doesn't become an unreasonable barrier to progress.

11. A formal decision on our borrowing policy may be required once our borrowing powers and limits are confirmed, and we may need to come back to Cabinet for formal approval of the regulations in due course. At this stage it would however be helpful for the Cabinet to approve in principle the application of borrowing powers, and therefore to mandate officers to secure the most flexible regulations possible.

12. In the meantime, we are progressing a number of investment opportunities that would benefit from the new powers; for example in establishing investment plans for Enterprise Zone development.

FINANCIAL IMPLICATIONS

13. There are no direct financial consequences arising from this paper. Once the statutory framework is in place, individual decisions to apply borrowing powers for particular projects would be made by the Cabinet as individual proposals come forward. The Finance Director would advise on the application of the Prudential Code in each case.

LEGAL IMPLICATIONS

14. There are no direct legal consequences arising from this paper. If agreed, officers will work with government officials to secure the appropriate legal framework.

RISK ASSESSMENT

15. There are no direct risks arising from this paper. The risks of the adoption of any application of borrowing powers will be assessed on a project by project basis as and when they come forward to Cabinet for decision.

CONSULTATION

16. No formal consultation on the matters set out in this paper has been undertaken at this point.

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