

## ABERDEEN CITY COUNCIL

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| COMMITTEE       | Finance and Resources                               |
| DATE            | 28 <sup>th</sup> September 2010                     |
| DIRECTOR        | Gordon McIntosh                                     |
| TITLE OF REPORT | Tax Increment Financing for the City Garden Project |
| REPORT NUMBER:  | EPI/10/239  |

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### 1. PURPOSE OF REPORT

To outline the main issues associated with the possible establishment of a Tax Increment Financing scheme to help fund public infrastructure investment in the City Garden project.

### 2. RECOMMENDATION(S)

- i.) To approve the inclusion of several other important city centre projects, within an expanded TIF business case. These are projects which the Council would wish to progress regardless of whether or not the City Garden project is realised.
- ii.) To note that a subsequent paper may require to be submitted to the next Finance and Resources Committee meeting to seek approval for a Council contribution<sup>1</sup> towards additional consultancy costs - over and above the agreed £100K being provided by Scottish Enterprise - which are directly related to the inclusion of additional projects within an expanded TIF business case.
- iii.) To note the fact that a final TIF Business Case Report will be presented to Council for approval on 27 April 2011.

### 3. FINANCIAL IMPLICATIONS

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<sup>1</sup> The amount of any contribution will not be known until a revised quotation has been received from PWC. It is possible that no additional contribution will be needed. However SE have made it clear that they cannot contribute more than £100K. Therefore any expansion to the scope of work, asked for by Council Officers, will need to be paid for by the Council. Alternatively, a more focussed, less expansive (and probably weaker) report will be produced

The business case for a TIF scheme, currently being prepared by PriceWaterhouseCoopers (PWC) will set out, in some detail, the financial and other risks associated with the project.

The terms of PWC's assignment make it clear that they are required to produce a business case that ensures zero financial risk to the Council.

The business case will therefore be constructed to ensure that there will be no revenue and/or capital implications for the Council, in current and future years, or any financial risk arising from the project. The business case document will identify the exact means by which this will be achieved.

Therefore, although there will be additional consultancy costs relating to the production of an expanded TIF Business Case (as outlined in section 5) this project will have no other financial implications for the Council.

Finally, given the Council's stated position that they will make no financial contribution to the City Garden project, there are likely to be few State Aid implications associated with this project. If there are any State Aid implications, these are most likely to arise in connection with lease arrangements pertaining to any Council controlled land that will be needed for the development. This will therefore be investigated, in some detail, before creating of the Special Purpose Vehicle that will take the project forward into the planning and construction phases.

#### 4. OTHER IMPLICATIONS

In order to determine their support for the City Garden Project, Aberdeen City Council will need to satisfy themselves that the:

- a) business case, in terms of the expected economic benefits and the project financing arrangements are realistic and achievable
- b) Scottish Futures Trust have approved the business case and agreed to recommend approval of a TIF scheme to Scottish Ministers
- c) project can be delivered without any financial input from the Council.

Numerous legal, resource, personnel, property, sustainability, environmental, health and safety and/or policy implications and risks will inevitably need to be dealt with as the project progresses. These will become clearer as the work plan is progressed and will be flagged up to Council at the appropriate time.

#### 5. BACKGROUND/MAIN ISSUES

There has been much debate, mostly in the local press, as to what a TIF scheme and what it is not.

At various stages this debate has suggested that a TIF scheme will;

- Expose the Council to a situation whereby they will inevitably need to put money (either revenue or capital funding) into the construction of the City Garden project and this will therefore inevitably impact on resources available for other capital projects that the Council may wish to initiate.
- Expose the Council to a situation whereby they will need to pay interest and capital on any funds borrowed from the Public Works Loan fund as part of the TIF scheme, which will place an unreasonable burden on the Council at a time of financial constraint.
- Expose the Council to a situation where they will need to contribute to the ongoing operational costs of the City garden development, after it has been built.
- Directly increase business rates in the immediate vicinity of the City Garden Project

It must be stressed that a TIF scheme will not lead to any of the above scenarios, for the following reasons:

Firstly, although the TIF business case needs to demonstrate a justifiable need for public sector funding, this funding will be supplied by additional borrowing from the Public Works Loan Board. This additional borrowing can be afforded because the capital and interest on these borrowings will be repaid from incremental tax revenues generated as a result of increased business activity and property values that will be generated as a result of the investment made in the City Garden project and associated developments in the immediate vicinity. The fact that additional borrowings are being used means that there will be no impact upon the Council's currently available capital budgets. Therefore there will be no impact on other Council projects that are due to be funded from the Council's capital budget.

Secondly, although a certain level of incremental tax revenues must be generated to cover the interest and capital payments on the borrowings, the TIF business case will need to demonstrate that there is absolutely no risk of the Council having to make up any shortfall in the expected level of incremental tax revenues - by confirming that any shortfall will be guaranteed by a third party, for example. Therefore, since the Council will never be required to contribute revenue or capital funds to meet capital and interest payments on the debt, there will be no impact on the amount of revenue funds available for other Council services.

Thirdly, once completed the business plan for the City garden development will need to be approved by the various stakeholders in the project. The Council has made it clear that this business plan cannot include any possibility that the Council will provide capital or revenue funding for the project. An

agreement to this effect will be drafted as part of the arrangements for establishing and funding the special purpose development company that will be established to take the development forward into the planning and construction phases.

Fourthly, TIF schemes do not increase business rates. Potential business rate increases arise from new investment, which leads to more business activity and increased property values in the surrounding area. TIF simply enables the Council to capture the incremental increase in tax revenues and use this to repay debt and interest on borrowings used to finance public infrastructure works that enable new investment. Without a TIF scheme these incremental tax revenues would flow into the Scottish Government for re-distribution (or not, as the case may be) through the normal local government funding formula/mechanism. An explanation of how a TIF scheme works is attached as Appendix 1. This has been prepared by PWC.

As previously stated, PWC have been tasked with producing a TIF Business Case. This business case will describe how the City Garden project, together with a number of other nearby developments, can create a vibrant and dynamic cultural and leisure quarter in and around the Union Terrace/Belmont Street area of the City. The business case will also demonstrate how this can be done without any financial risk to the Council.

The current draft, outline content of the proposed TIF business case report is attached as Appendix 2. This is in the process of being amended to take account of the additional activities associated with expanding the TIF business case. Nevertheless, it gives a good idea of the scope of the work and the issues that will be dealt with as part of the business case.

From this it can also be seen that the rationale behind the business case, and the expected economic impact of the project, will form a substantial element of the business case - which will need to be robust and open to rigorous challenge, from both the Scottish Futures Trust and the various stakeholders with an interest in the project.

It should also be noted that the Council will need to approve the TIF Business Case before they submit it to the Scottish Futures Trust, for subsequent Scottish government approval. Consequently, if the TIF business case fails to clearly mitigate all possible financial risks to the Council, they are under no obligation to approve and submit it to the Scottish Futures Trust. The Council will therefore have the final say in determining whether they wish to apply for a TIF scheme.

With regard to the costs associated with producing the TIF business case, Scottish Enterprise has agreed to meet these, up to a maximum cost of £100,000.

However Committee should be aware that Council Officers have requested a considerable extension to the scope of this study, to encapsulate other possible developments within the immediate area surrounding the City

Garden project. Such an expanded business case would include the following additional projects:

- a) Public realm works associated with the creation of a high quality pedestrian route linking Union Square, the City Garden, Aberdeen Art Gallery, the Bon-Accord Centre and St Nicholas House (in anticipation of its future redevelopment). [Note: This would not necessarily involve the pedestrianisation of any roads]
- b) Demolition, site preparation and enabling infrastructure related to regeneration of Upper Denburn (incl. Denburn Health Centre and Car Park)
- c) Enabling infrastructure and construction costs related to Aberdeen Art Gallery extension
- d) Demolition, site preparation and enabling infrastructure relating to the redevelopment of St Nicholas House.

The request to include these projects in an expanded TIF business case has been made to ensure that the economic impact benefits of these projects are also captured within TIF business case, together with the public infrastructure costs associated with each project.

This will mean that the expanded business case can be readily modified to ensure the proposed TIF scheme might still be used to fund these projects, even if the City Gardens Project does not go ahead (for whatever reason).

If these projects are not included in an expanded TIF business case, at this point in time, and the City Gardens Project does not proceed, an entirely new business case would need to be produced for the other projects. This would greatly increase the time needed to gain approval for any TIF scheme based on these projects alone (i.e. without the City Garden Project). In such a scenario, Aberdeen could miss out on the initial round of TIF schemes, with no guarantee that a second round would be forthcoming.

However, including as many projects as possible in this initial TIF Business Case means that the overall cost of preparing the TIF business case could exceed the £100,000 allocated by Scottish Enterprise.

Whilst appreciating the Council's desire to avoid contributing to any costs associated with the City Garden Project, including the projects mentioned above in the TIF business case is viewed as a reasonable use of Council funds.

Committee are therefore being asked to note that a subsequent paper may be presented to the next Finance and Resources Committee seeking approval for a contribution towards any additional consultancy costs, over and above £100,000 being met by Scottish Enterprise, which are directly related to the

inclusion of additional projects in an expanded TIF business case - at the Council's request.

As yet the final cost of producing an expanded TIF Business Case is not known and it could be that it does not exceed £100K. Once the total cost is known any required Council contribution will be sought on the understanding that, if approved, these additional funds will be met from the current EP&I budget.

## 6. IMPACT

### Corporate

This project is seen as a critical project with regard to the future attractiveness, vitality and connectivity of the City Centre and links to both the **Single Outcome Agreement** and **Community Plan 2008**, which outline a vision for Aberdeen City which wealthier, greener and safer and delivers the following National Outcome's:

- 1 We live in a Scotland that is the most attractive place for doing business in Europe
- 2 We realise our full economic potential with more and better employment opportunities for our people
- 10 We live in well-designed, sustainable places where we are able to access the amenities and services
- 12 We value and enjoy our built and natural environment and enhance it for future generations.
- 13 We take pride in a strong, fair and inclusive national identity
- 15 Our public services are high quality, continually improving, efficient and responsive to local people's needs.

The project also contributes to the City's **Vibrant, Dynamic & Forward Looking: policy document**, since a fully functioning and well utilised City Gardens represents a vital piece of social, cultural and leisure infrastructure that can contribute to the delivery of the Aberdeen City and Shire Economic Future's '**Building on Energy - An Economic Manifesto for Aberdeen City and Shire**'. This in turn supports the strategic vision of Aberdeen City and Shire, which is to be recognised as one of the most robust and resilient economies in Europe with a reputation for opportunity, enterprise and inventiveness that will attract and retain world-class talent of all ages.

### Public

This report, like all reports pertaining to the City garden Project will be of interest to the general public, particularly to those people who oppose any type of development in Union Terrace Gardens.

It is also anticipated that the project will have a positive impact in terms of the Equalities and Human Rights Impact Assessment, as a direct result of linkages to the Economic Development theme of **Vibrant Dynamic and Forward Looking** and it's expected impact on the future sustainable development of the Aberdeen City and Shire economy, by making a major contribution to Aberdeen's business and social infrastructure that supports local businesses and provides a venue for major social, leisure and cultural events for all Aberdeen citizens.

7. BACKGROUND PAPERS

None applicable.

8. REPORT AUTHOR DETAILS

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## Tax Increment Finance (“TIF”) Basic Facts

### What it is

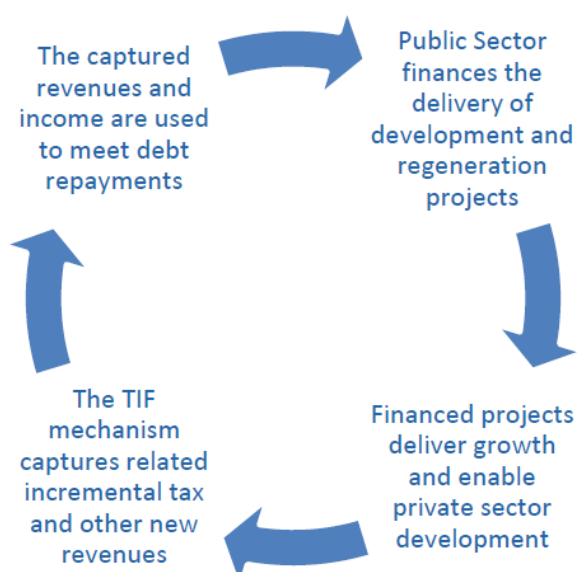
TIF is a way for the public sector to fund infrastructure investment, to drive regeneration and unlock economic growth, by borrowing against the future **additional** tax revenues which the infrastructure investment unlocks. In essence “paying for growth with growth.”

A number of local authorities in Scotland, and across the UK, are currently investigating the potential use of TIF for infrastructure investment and regeneration.

### How it Works

1. In general, investment in infrastructure and regeneration is expected to lead to an increase in economic activity, an improved business environment and a resulting increase in property values and business rate revenues;
2. The public sector identifies a ‘red-line area’ within which economic growth is constrained by market failure or a lack of private sector investment;
3. The public sector identifies and prioritises the investment needs of the red-line area in terms of those projects that would most readily kick-start or enable regeneration and economic growth – ‘enabling infrastructure’ e.g. roads, public transport, public realm;
4. An economic impact assessment is undertaken to assess the potential for this enabling infrastructure to unlock net additional private sector investment and economic activity within the red-line area (whilst accounting for factors such as the displacement of existing economic activity from areas outside the red-line area to within it);
5. If sufficient net economic benefit is expected to arise the public sector can invest in the enabling infrastructure;
6. Consequent private sector investment results, bringing increased economic activity, and therefore **additional ‘incremental’** taxation revenues, to the area (and potentially other revenues e.g. transport fares, car park charges);
7. TIF provides the mechanism for the public sector to capture this incremental tax revenue and retain it locally for the purpose of servicing and repaying the initial investment in the enabling infrastructure; and,
8. TIF does not require an increase in the tax rate but instead captures the growth in the tax pool that arises as a result of the initial investment financed through TIF.

Thus there is a ‘virtuous circle’ linking accelerated public sector investment to economic growth and fiscal benefits:





# TIF Business Case Report – Draft Contents<sup>2</sup>

## Executive Summary

### 1. Introduction

- Key sponsor(s)
- The vision, aims and objectives of the TIF

### 2. Context of the Scheme

- Outline the regeneration vision for the proposed TIF area and how the proposals fit into a wider development plan for the area
- Consider how the TIF delivers / fits with other local, regional and National policy objectives and initiatives
- Identify key stakeholders, land owners and partners and their likely roles and resources in relation to the TIF
- Describe the scope of the TIF proposals e.g. a description of the proposed TIF area (or “Red Line”), infrastructure needs and early priorities, expected overall private sector development unlocked
- Highlight the But-For case – setting out the status / funding sources and prospects for the area / proposals without TIF (the “counterfactual”) and the range of options considered in determining the suitability of TIF for the proposed area – i.e. an options appraisal in terms of considering other forms of delivery / financing for the proposed area. This should also relate to economic analysis undertaken in support of the TIF proposals
- The likely private sector / additional development that would be created by the TIF enabling infrastructure / investment and its certainty, both in terms of construction and revenues.
- Details of the likely revenue sources created by the TIF, along with the rationale for their availability and use

### 3. Infrastructure Investment Plan and Prioritised Assets

- The overall infrastructure requirements within the TIF area, classified along the lines of enabling (i.e. necessary to initiate development), reactive (i.e. necessary in the longer term) and enhancements ([i.e. quality of life enhancements])
- A high level description of the proposed infrastructure
- Costings (including risk allowances and optimism bias) for infrastructure and details of any supporting advice, work or consideration to date
- Proposed programme (referring to wider development and prioritised programme)

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<sup>2</sup> This is currently in the process of being amended by PWC, to reflect the inclusion of the additional projects highlighted in the paper, which will form the basis of an expanded TIF business case

- Sources of finance and related certainty, particularly if private sector funding
- Any existing / other available sources of funding and finance, both public and private (outwith the TIF) e.g. s75 contributions, existing budgets, efficiencies, etc, with an aim of identifying the funding gap for the infrastructure elements potentially financeable through TIF (both for an overall and prioritised assets basis).
- Proposals around any prioritised assets / infrastructure, if applicable, including basis of selection and related options appraisal, potential revenue outputs and costs
- How the principles of sustainable development have been incorporated into any proposals

#### 4. Economic Analysis

The outturn of the economic analysis should be incorporated into the financial analysis, to understand the revenue generation capability of the TIF area and its ability to meet its obligations going forward (e.g. debt service)

The ex-ante assessment of the economic case should incorporate:

- Assessment of the market failure / failure of equity addressed by the intervention
- An assessment of the counterfactual i.e. what would have happened if the TIF did not occur
- An assessment of the economic impact of the intervention showing minimum, most likely and maximum impact over a 25 year appraisal period
- An evaluation of factors such as potential displacement, deadweight and leakage as a percentage of economic impact at both a local and regional level showing minimum, most likely and maximum cases – noting that as the geographic area increases, the certainty of analysis reduces
- In terms of potential impact at a national level, consideration should be given as to how any TIF proposals will deliver benefits nationally, the likely form these will take and how they fit with the strategic objectives of the Scottish Government

Further guidance in relation to the economic analysis will be attached as a separate Annex.

Economic assessments to be carried out:

- Specifically based upon the circumstances of the TIF scheme (not from historic parallels)
- Utilising interviews with and submissions from key stakeholders, local organisations / bodies affected by the TIF and other relevant parties
- According to recognised best practice methodologies
- By an objective economist with a recognised track-record of economic assessment for public bodies

## 5. Financial Analysis

Financial analysis of the TIF proposals should be undertaken through modeling the project over a 25 year period. The Financial Model and its outputs should include:

- Uses of funds linked to the TIF infrastructure investment plan
- Forecast tax increment available for financing to include non-domestic rates and other identified incomes, net of the economic assessment of most-likely displacement and leakage
- Sources of funding e.g. s75 contributions, other existing forms of funding (both public and private), prudential borrowing, including deliverable draw-down / repayment assumptions and a funding cost buffer;
- Profiling of costs and revenues
- Key assumptions (e.g. cost and source of any funding, inflation) and ratios (where applicable) utilised in the Financial Model
- Details of the proposed levels of non-domestic rates and other identified incomes utilised by the TIF e.g. % of NDRs, % of transport revenues
- Details of any request for underwriting / guarantee at a Government level, including details of potential exposure for Government, and the basis upon which the position would be remedied going forward
- How, if applicable, would the public sector share in the value creation / outcomes of the private sector development
- Details in relation to the sharing of enhanced outcomes (i.e. greater upside than forecast e.g. increased property values from initial infrastructure investment and overage provisions), proposed mechanisms and who would benefit (i.e. SG, the Local Authority, Developers, etc)
- Sensitivity analysis considering key variables: delay, interest rate movements, inflation rate movements, displacement range, increased construction costs, etc

## 6. Risk

- Consideration of risk: including risk identification, allocation and management. Such elements may include:
- Key viability risk considerations including:
  - LA vires (including asset ownership issues and access to funding);
  - Procurement approach and strategy;
  - State aid;
- Key delivery risk considerations including:
  - Linking infrastructure to development
  - Incentivising the development partner
  - Project risks e.g.:
    - Cost over runs
    - Delays in starting / finishing construction
    - Lower than anticipated occupancy rates
    - Changes in economic environment

- Details of key agreements / contracts likely to be required, and where applicable / available, an outline of the basis of such documents
- The Business Case should include a description of the opportunities for transferring risk to the private sector (and the likely pricing of that risk)

## **7. Delivery**

- Delivery structure /options
- Proposed governance and management structures and roles of key parties / individuals
- How the overall structure addresses the key risks and issues identified under section 6. Risk
- Procurement and how Value for money will be delivered / assessed
- The delivery section should also consider:
  - How will the TIF be monitored and managed e.g. details of likely KPIs, reporting regime
  - Resourcing at different levels e.g. Local Authority, overall delivery and any, if required, additional vehicles
  - Internal / external resources available, and their suitability, for the delivery / management of the TIF
  - How both the public and private sectors are incentivised, and details of any underlying payment mechanisms, key payment milestones, etc
  - Details of key individuals

## **8. Next Steps**

- Should include discussion of:
- Programme and key milestones
- Critical next steps towards delivery
- The strategy for taking forward the project and responsibility for doing so

## **9. Conclusion**