Deal or No Deal? UK City Deals as Infrastructure Funding and Financing Mechanisms

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1. Speculative Urbanism in a time of Austerity

Following an initial phase of co-ordinated economic stimulus, in response to the Global Financial Crisis and its aftermath, austerity policies and practices are now being implemented by a number of nation states (Donald *et al*., 2014). Cities and city regions represent a useful spatial unit of analysis in which to examine the pattern and nature of austerity, and to assess how different places are responding to crisis and delivering investment in urban infrastructure assets and systems (Hall and Jonas, 2014). The implementation of austerity is said to form part an ideological blueprint where budgetary pressures are used as the rationale for introducing smaller state settlements (Peck, 2012), and where a model of neo-liberal urbanism shapes and reshapes the landscapes of local economic development and governance (Peck *et al*., 2013).

The ability of cities and city-regions to source and deploy new forms of public and private capital is highly variegated (Peck and Theodore, 2007). Some cities are able to mitigate the inherent risk that certain financial models bring, whereas other places do not have sufficient scale, size or market conditions to adopt and implement financialised initiatives, and are therefore leaving themselves exposed to greater fiscal stress if planned investment schemes fail (Weber, 2010).

The urban landscape is an important context in which to explore the funding and financing of infrastructure because infrastructure networks are the main physical and technological assets that bind cities and city regions into functional economic geographies (Graham and Marvin, 2001). Since the 1970s, there has been a shift away from integrated, bundled infrastructure networks (Graham, 2000) and a move towards specialised, privatised and customised products, with the result that infrastructure has been opened up to private owners that are increasingly embedded within global flows of finance and capital (Graham and Marvin, 2001). As urban infrastructure becomes interlinked with specialist global infrastructure funds, internationalised actors are playing an influential role, alongside national and city states, in the governance and regulation of city infrastructure assets and systems (Torrance, 2008; Pagano and Perry, 2008).

Greater collaboration between local state actors and private interests has been evident in the material appearance of 'urban entrepreneurialism' (Harvey, 1989), where the boundaries between public and private sectors are redrawn across service provision, infrastructure finance, delivery and operation (Whitfield, 2010). This has led to greater commodification of space and the public sphere, emboldened recently by austerity, where cities are encouraged to embrace new private sector-led models of urban governance and agency (Meegan *et al*., 2014). As the 'modus operandi' of urban development and governance since the early 1980s (Davidson and Ward, 2014), speculative urbanism involves private actors and the state interacting in a symbiotic process of negotiation and transaction (Goldman, 2011). Cities, for example, are encouraged to adopt risk-taking urban development policy and strategy (Peck *et al*., 2013), and formulate new territorial alliances (Ward, 2013). Bound up within a pervading global system of financialisation, cities are required to embrace innovative financial mechanisms and practices (Harvey, 1989), which are often characterised by the apparent willingness of local governments to borrow against future revenue streams in an effort to deliver infrastructure projects that will 'unlock' growth and development.

2. Centre-local Relations and Governance

The nation state played a pivotal role during and in the aftermath of the Global Financial Crisis (Dicken, 2011), in a period when longer-term, qualitative transformations have been taking place in how the state organises and discharges the functions of local and regional development. The changes include territorial 'rescaling' and sub-national governments assuming new policy and fiscal responsibilities (Lobao and Adua, 2011).

One of the more visible illustrations of state decentralisation (Pike and Tomaney, 2009) has been the increasing level of competition between cities, city regions and regions for investment, jobs and resources; based on the unproven premise that all places can be winners if they follow similar market-led development and growth policies (Bristow, 2010). However, this approach ignores the evidence that capitalism is spatially-variegated (Peck and Theodore, 2007; Peck *et al*., 2013), and that contingency (including institutional architecture) shapes and reshapes the nature of local and regional development interventions (Dicken, 2011).

Our interest in the governance of local infrastructure funding and financing stems from the uneven economic geographies in which these processes are unfolding and taking root, as well as the specific role and function of local and regional institutions in promoting or hindering economic growth (Martin, 2000; Rodríguez-Pose, 2013; Tomaney, 2014).

Amidst the drive for greater decentralisation, the city region has emerged recently as a dominant framework of sub-national economic analyses and development planning (Coombes and Champion, 2011), and has been given fresh impetus by the active promotion of 'Regional Urbanisation' (Soja, 2000), 'Metropolitan Regions' (Katz and Bradley, 2013), and the apparent linkages between city region governance systems and economic performance (Ahrend *et al*., 2014). These debates have a long history, and academics and policy-makers have been concerned for some time that "metropolitan regions are often chaotic and ungovernable" places (Storper, 2013: 1). The planning and implementation of economic interventions (including infrastructure planning) at the city region scale requires the co-ordination of institutional actors (Brenner, 2004), and the alignment of local institutional arrangements with functional economic areas (Crouch, 2011). This means that local authorities will often spend considerable time building and maintaining city region-wide governance and leadership (Nelles, 2013) in an effort to establish effective municipal cooperation (Ahrend and Schumann, 2014).

3. Infrastructure as an Asset Class and Emergent Infrastructure Funding and Financing Practices

Faced with declining revenues, local public authorities are turning towards national and international private capital. Whilst these new relationships may provide potential sources of investment, they also pose fundamental questions about the governance and regulation of local infrastructure funding and financing.

With demand for infrastructure renewal and maintenance growing, traditional sources of infrastructure funding and financing are under stress, with attention turning to how infrastructure can be financed as an alternative asset class (OECD, 2013). Institutions, including pension and insurance funds, are seen as new sources of investment (PwC, 2008) as infrastructure offers the potential to generate the stable, long-term, inflation protected returns that investors are seeking.

A variety of urban infrastructure funding and financing practices have emerged recently (Strickland, 2014) (Table 1). Local government in the UK has tended to derive capital resources through central government grants and prudential borrowing, whereas in the US there is a long history of municipal borrowing from bond markets to finance infrastructure investment. Traditionally, UK local authorities have undertaken prudential borrowing from the Public Works Loan Board (PWLB). The PWLB is administered by the Debt Management Office, an agency of the UK Treasury. In 2013, 75% of all UK local authority borrowing was provided by the PWLB (Andersson, 2014). The extent of the PWLB’s influence as a lending facility was illustrated when the UK Government increased the PWLB interest rate in October 2010, and borrowing by local authorities fell subsequently by 93% the following year (LGC, 2011).

A noticeable shift has also taken place in the UK away from grant-based mechanisms in favour of investment-type infrastructure and regeneration projects and programmes (CLES, 2012) based on loan-based revolving or recycled funds. The same is true across the European Union where existing local and regional development programmes are sponsoring the creation of new models to generate financial returns on investment. In 2008, the Core Cities Group identified a set of financial tools that could enable local authorities to deliver major regeneration projects that required investment in ‘enabling’ infrastructure (Core Cities/PwC, 2008) (Table 2). The measures included: Business Rate Supplement; Community Infrastructure Levy; Recycled Infrastructure Funds, Accelerated Development Zones and Tax Increment Financing (TIF).

Table 1: Infrastructure Financing and Funding Practices

Temporality	Type	Examples
Established, ‘Tried and tested’	Taxes and fees	Special assessments; User fees and tolls; Other taxes.
	Grants	Extensive range of grant programmes at multiple levels (e.g. federal national, province, state, supranational)
	Debt finance	General obligation bonds; Revenue bonds; Conduit bonds; National Loans Funds (e.g. PWLB).
	Tax incentives	New market/historic/housing tax credits; Tax credit bonds; Property tax relief; Enterprise Zones.
	Developer fees	Impact fees; Infrastructure levies.
	Platforms for institutional investors	Pension and Insurance infrastructure platforms; State infrastructure banks; Regional infrastructure

		companies; Real estate investment trusts; Sovereign Wealth Funds.
	Value capture mechanisms	Tax increment financing; Special assessment districts; Sales tax financing; Infrastructure financing districts; Community facilities districts; Accelerated development zones.
	Public private partnerships	Private finance initiative; Build-(own)-operate-(transfer); Build-lease-transfer; Design-build-operate-transfer.
Newer, 'Innovative'	Asset leverage and leasing mechanisms	Asset leasing; Institutional lease model; Local asset-backed vehicles.
	Revolving infrastructure funds	Infrastructure trusts; "Earn Back"/ "Gain-share" funds.

Source: Adapted from Strickland, T. (2014).

Table 2: 'New' Funding Tools and Vehicles proposed by Core Cities/PwC

Tool/Vehicle	Description
Business Rate Supplement	A tool that will enable cities to levy an additional supplement on the national business rate within their area. Funds generated would be retained locally, and used to underpin borrowing and other forms of capital financing to generate additional infrastructure investment.
Community Infrastructure Levy	A standard charge levied by local authorities on new development to ensure that developers contribute to the infrastructure improvements.
Recycled Infrastructure Funds	Funds that invest (in whole or in part) in physical infrastructure, which in turn enables associated land to be released for development over time. Key infrastructure can be delivered early in the development process. A proportion

	of the value of the development land released is used to pay back the Fund for its initial investment.
Tax Increment Financing/Accelerated Development Zones	Allows local authorities to capture incremental value in the form of tax revenue generated from new development. Cities need to retain long-term local tax revenues generated from development, such as business rates, allowing funds to be raised for investments through securitisation of those revenues.

Source: Core Cities/PwC (2008)

4. The Local Growth Agenda

In May 2010, the UK Coalition Government professed that 'radical devolution' would be one of its central objectives (Cabinet Office, 2010). The 2010 Local Growth White Paper laid the ground for the Coalition's approach to sub-national development in England, and has been framed around: shifting power to local communities and business; enabling places to tailor approaches to local circumstances; providing incentives for growth; and supporting investment in places and people to tackle barriers to growth. The Local Growth agenda also represents an attempt to link geographical understandings about scale and place with political analysis interpretations of decentralisation, participation, and community and managerial approaches to efficiency and market-orientated public service delivery (Clark and Cochrane, 2013).

On a policy level, Local Enterprise Partnerships (LEPs) have replaced Regional Development Agencies in England (Pike *et al*., 2013), and reforms to strategic planning have been enacted alongside changes in local government funding. These elements have been shaped, to varying degrees, by the Government's core macro-economic objective of reducing the UK's structural budget deficit by implementing a fiscal consolidation package worth £113 billion per annum over five years (IFS, 2014).

Public spending reductions, which comprise 80% of fiscal consolidation, have resulted in local government spending fall by nearly 30% in real terms (CIPFA, 2014). A new system of local government funding in England sees local authorities now retain 49% of locally-raised business rate income, with the remainder ‘passed’ to central government. The new scheme – the Business Rate Retention System (BRRS) – will be ‘reset’ every 10 years (DCLG, 2012), and local authorities will become increasingly dependent upon locally-generated business rate revenue for future income (HoC, 2013).

5. City Deals

As part of the Local Growth agenda, the Coalition Government has been considering the role of cities and city regions in supporting economic recovery, rebalancing and infrastructure planning and delivery. The City Deals, which were launched in December 2011, provide an instructive account of how the governance of local infrastructure funding and financing in the UK is changing:

> We want powerful, innovative cities that are able to shape their economic destinies, boost entire regions and get the national economy growing. The aim of these Deals is to empower cities to forge their own path, to play to their own strengths and to find creative solutions to local problems (Nick Clegg, Deputy Prime Minister, Foreword, Unlocking Growth in Cities, 2011).

The first Deals focused on the 8 largest cities outside London (the Core Cities) (Cabinet Office, 2011),[1] with cities specialising in a distinctive policy area and identifying a further set of specific issues that were said to represent barriers to local growth. In October 2012, the Government invited 20 more cities to submit expressions of interest in negotiating City Deals (Table 3), and proposed two elements in the Wave 2 Deals: a bespoke element, reflecting specific city needs; supplemented by a ‘Core Package’ of powers that recognised some common challenges facing most cities – and which had been identified earlier by Wave 1 cities. The Government also announced, around the time of the 2013 Autumn Statement, that a Glasgow City Deal would be taken forward (HMT, 2013).

Table 3: Wave 1 and Wave 2 City Deals

[1] Liverpool City Council agreed the first City Deal, which led to an Elected Mayoral system being introduced and a Mayoral Development Corporation for Liverpool City being established. The Liverpool City Region (including Liverpool City) agreed a further City Deal.

Wave 1	Wave 2
Greater Birmingham and Solihull Bristol and West of England Greater Manchester Leeds City Region Liverpool City Region Nottingham Newcastle Sheffield City Region Liverpool Mayoral Deal	The Black Country Thames Valley Berkshire Bournemouth Plymouth Brighton and Hove Preston and Lancashire Greater Cambridge Southampton and Portsmouth Coventry and Warwickshire Southend Hull and Humber Stoke and Staffordshire Greater Ipswich Southend Leicester and Leicestershire Stoke and Staffordshire Milton Keynes Sunderland and the North East Greater Norwich Swindon and Wiltshire Oxford and Central Oxfordshire Tees Valley

Source: Cabinet Office

5.1 Infrastructure Funding and Financing in the City Deals

In an attempt to help prospective Wave 2 cities, the Government published a 'menu' of infrastructure finance-related options for cities to consider including in their Deals. The options were: giving cities one consolidated capital investment pot; access to TIF; the pooling of business rates across local authority areas; devolving local transport major funding to cities; increasing cities' control over rail services; developing specific proposals for introducing greater accountability to local communities for local bus services; enabling cities to strengthen their use of local assets to invest economic development; devolving Homes and Communities Agency funding and responsibilities; and providing £100 million for broadband infrastructure (Cabinet Office, 2011).

Each Wave 1 City Deal contained a specific infrastructure financing element (Table 4), such as an integrated investment fund, the devolution of local transport funding, and TIF or 'Earn-back' mechanisms where cities borrow against future business rate revenue or tax receipts.

Table 4: Infrastructure elements in the Wave 1 City Deals

Instrument	**City Deal**	**Detail**
'Earn-back'	Greater Manchester	A payment by results infrastructure investment approach that is based on raising GVA growth, from which Greater Manchester earns back a return of national tax take.
Tax Increment Financing (New Development Deals)	Newcastle, Sheffield City Region and Nottingham	Borrowing to finance critical infrastructure against future business rates.
Economic Investment Fund	All City Deals	Pooled funding and business rates.
Rail Devolution	Greater Manchester, Bristol and West of England, Leeds City Region and Sheffield City Region	Commissioning and managing local and regional franchises.
Local Transport Major Funding	Greater Manchester, Greater Birmingham and Solihull, Bristol and West of England, Leeds City Region and Sheffield City Region	10 years devolved transport funding matched locally for strategic transport investments.
Low Carbon Pioneers	Greater Birmingham and Solihull, Leeds City Region, Greater Manchester, Newcastle and Nottingham	Local programmes to reduce carbon emissions and invest in green infrastructure and city district heating systems.
Superfast broadband	Bristol and West of England, Greater Birmingham and Solihull, Greater Manchester, Leeds City Region and Newcastle	£100 investment fund.

Source: Adapted from Marlow, D. (2012).

The emergence of TIF within the City Deals has been linked to the new model of local government funding in England. In their respective City Deals, Newcastle, Sheffield and Nottingham have been given 'permission' by Treasury to borrow up to £150m between them against long-term business rate income to invest in local infrastructure and regeneration projects. Significantly, the three City Deals do not contain a reset mechanism, unlike the

BRRS, in order to provide each of the cities/city regions with increased certainty around future business rate revenue.

Whilst TIF offers a potential tool for supporting local growth, it also draws cities into a financialised economy (Strickland, 2011; Weber, 2010). Strickland (2013) identifies important differences between TIF in England and in the US, where the model originated. He notes that Chicago has been able to transfer risk to private developers and financiers. In contrast, the version of TIF adopted in the City Deals takes development and construction risk *away* from the private sector as the costs are financed up front by the local authorities who also bear most of the risks.

One of the ‘innovative’ measures agreed in the City Deals was the ‘Earn-back' mechanism in the Greater Manchester City Region. Greater Manchester will invest £1.2bn (through local transport levies and borrowing) in transport infrastructure and then ‘earn back’ up to £30m per year for 30 years from central government in national tax receipt transfers, subject to Greater Manchester’s economy growing above a set baseline (LFC, 2013). The Deal took nearly two years to conclude, which raises questions about the efficacy of the deal-making process and whether sufficient capacity exists to conduct such negotiations:

> The Government’s capacity to work with 8 cities on a meaningful basis on the devolution agenda is stretching them. It needs resources from central government and our side to make it happen. Not just in terms of signing deals it is working through the barriers you hit after the Deal has been signed (Interview with a Local Authority Officer in a Wave 1 City Deal).

It is debatable as to whether the Deals represent a new innovation or if they simply provide an opportunity for existing local projects to receive Government backing at a particular point in the economic cycle, thereby giving Government and individual cities the opportunity to promote a potential ‘win-win’:

> If you were using the City Deal to finance something, which you already had on your books, which you could convince the civil servants actually met the criteria as they

> were applying them on that day, then you could fly out of the door on some of this (Interview with a Local Authority Officer in a Wave 1 City Deal).

The local infrastructure financing initiatives within the City Deals seem to have set a pattern, for the foreseeable future, and perhaps longer, for how public funds will be coalesced alongside and used to leverage private investment. Consequently, it is important that ongoing evaluation takes place into how different places have been able to invest in projects that can generate recycled funding, and have been able to bear the speculative risk of undertaking initial borrowing against future land and property value capture.

5.2 City Deals as Governance Mechanisms

The City Deals are having a profound impact on the governance of local economic development in England. One of the pre-requisites for the UK Government agreeing to sign individual City Deals has been that local authorities strengthen and reform local governance and decision-making arrangements (Cabinet Office, 2011):

> Anybody that doesn't have a governance structure that will make it [the City Deal] work, isn't getting a City Deal (Interview with Ministerial Adviser).

The expectation of 'stronger' local governance has since been re-visited through LEP Strategic Economic Plans and Growth Deals, with Combined Authorities or Directly Elected Mayors cited by ministers as preferred governance structures. However, for some cities and city regions, these models are not viable options:

> We very quickly had to say to Cabinet Office, look the governance arrangements that were typical in Wave 1 Deals were not going to work for us. So we had to persuade the Cabinet Office that alternatives were necessary (Local Authority Leader in a Wave 2 City Deal, transcript of LGA debate on City Deals, 4 April 2014).

The UK Government also pushed for Wave 2 Deals to encompass a wider geography and a stronger element of competition between cities (Fahnbulleh, 2012). Paradoxically, this may have limited the scale of ambition that materialised in the Wave 2 Deals (Marlow, 2014), whilst the emergence of Local Growth Deals, which were based on recommendations in the Heseltine Growth Review (Heseltine, 2014), cut across some of the Wave 2 City Deal negotiations that were reaching their conclusion in spring 2014. One of the key differences between the Wave 1 and Wave 2 City Deals is how far the Government has been willing or able, despite the initial rhetoric, to agree to genuine devolutionary measures:

> Wave 1 was more comprehensive and probably able to be more ambitious. The Cities Policy Unit was able to get greater changes out of the Departments in those early stages and by Wave 2 the Departments had caught up and were less prone to accept radical change (Interview with a Local Authority Officer in a Wave 2 City Deal).

Table 5: Governance mechanisms in Wave 1 City Deals

Governance model	**City Deal area**	**Outline Description**
Elected Mayor	Liverpool, Bristol	Mayor plus 'strong decision-making across wider economic area', Skills Board (Bristol and West of England) and Transport Board (Liverpool City Region).
Combined Authorities	Greater Manchester, Leeds City Region, Sheffield City Region, Liverpool City Region and North East (Newcastle)	In Leeds and Sheffield City Regions these are West Yorkshire and South Yorkshire-based – not for whole city region/deal area but for metropolitan unitary authorities.
LEP-led	Greater Birmingham and Solihull	'Particularly strong private sector leadership', plus Capital Board and Housing and Growth Board. Discussions are taking place on the possible creation of a 'Greater Birmingham' City Region Combined Authority.
None specified/city council	Nottingham	City Deal is focused on the City's 'Creative Quarter' and a new private sector led Economic Growth Board has been established.

Source: Adapted from Marlow, D. (2012)

It is possible to identify a series of common features in how all the City Deals have been designed to operate as governance mechanisms for local infrastructure funding and financing. First, the Deals are predicated on a ‘something for something’ transactional arrangement between the centre and a locality that is akin to a ‘payment by results’ model of public service delivery (DWP, 2014). Second, the Deals represent a move, in theory at least, towards greater self-help and reduced reliance on central government, with more locally-led funding, financing and risk-bearing. Third, underpinned by cost-benefit-type appraisal, the City Deals have been encouraged to demonstrate that they can support economic recovery by delivering infrastructure and regeneration projects that achieve the maximum impact on city-region economic potential (e.g. GVA, employment and productivity). Fourth, the Deals have been defined as providing greater ‘freedoms and flexibilities’ for local innovation. How far and how wide this has materialised in practice, though, remains questionable. Fifth, strong emphasis has been placed upon governance reforms at the city-region scale, with the Greater Manchester Combined Authority seen initially as a model of good practice, although for some cities and city regions such models are not feasible. Finally, the City Deals have been conducted against the background constraints of austerity. Despite recent reforms, UK local authorities have limited fiscal freedom (Travers, 2012). With deficit reduction an overriding political priority, the UK Government has been reluctant to back some innovative infrastructure financing proposals in the City Deals.

6. Conclusions

The governance of infrastructure financing at the city and city-region scales is critical to the search for new and innovative funding mechanisms for infrastructure assets and systems. The City Deals initiative has encouraged UK cities and city regions, at least initially, to develop and embrace speculative strategies to finance infrastructure investment at a time of local government austerity. The role of the UK nation state remains pivotal to enabling and hindering the ability of cities and city regions to invest in local infrastructure. The UK Government has been reluctant for local authorities to use the strength of the sovereign balance sheet to borrow for capital investment, despite historic low interest rates. The Government’s public approach has been to encourage cities to flirt with risky, complex and potentially more expensive investment activity. Steps have also been taken to reduce local government borrowing from the PWLB, although there has been a reversal recently of this ‘policy’. Our review and initial analysis of the City Deals suggests that the UK Government has been uncomfortable at the prospect of too many cities and city regions engaging in speculative activity at once. This illustrates the depths to which deficit reduction has remained the primary economic and political objective, albeit within a proclaimed era of localism and devolution. It also demonstrates the enduring centralised nature of the UK political economy.

It is too early to assess the overall performance of the City Deals (NAO, 2013), with the assumption that it will be some years before the Deals produce tangible outcomes (Nathan, 2011). We can, however, offer some tentative conclusions that the City Deals, when viewed in an international context, do not represent radical devolution. A small number of cities and city regions have embarked upon speculative investment to finance upfront infrastructure, and austerity has amplified the risks these places are taking amidst a background of declining local revenue. At the same time, the UK Government has instigated a strict set of fiscal rules around mechanisms, such as TIF and Earn-back.

At some point we should discover if the City Deals represent a genuine step change from previous attempts at sub-national devolution and governance (Ayres and Stafford, 2009). As a result of the City Deals, actors at city and city-regional levels are (re)configuring their institutional, governance and leadership arrangements in new ways to cope with a rapidly changing and uncertain context. What remains unclear, at this stage, is the extent to which the UK's highly-centralised system of governance is willing and able to build upon the experience of the City Deals, and embrace broader, more systemic and more permanent decentralised central-local relations.

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