Capitalising on the Boroughs

Promoting growth through greater financial devolution in London

A report from the Society of London Treasurers

Supported by:

Executive summary of key issues and recommendations

Increased financial devolution has the potential to significantly support London Boroughs as they cope with the on going impact of fiscal austerity on their budgets. How London Boroughs are funded is changing in an unprecedented manner. These developments have the potential to transform the financial risk landscape across London both positively and negatively. All other things being equal, the continuing financial sustainability of the sector will increasingly be a function of its ability to manage and share financial risk with other local public service partners and in so doing achieve savings 'across the system'. It will also be the product of successful local measures to deliver economic growth so long as the benefits of that growth are retained locally to fund services and investments. Both of these enablers require significant financial decentralisation and devolution.

Accordingly, London Boroughs should encourage measures that promote financial devolution, but this also means engaging thoroughly with preparations for the practical ramifications of its implementation. As a practical next step, SLT [1] recommends that London Boroughs individually and collectively contribute to the Independent Commission on Local Government Finance, launched by the LGA[2] and CIPFA[3]. Boroughs should also determine the organisational development implications of greater finance devolution, including proposals to support new skills and capability: regeneration, housing and infrastructure development, economic analysis, insight, business case development and commercial negotiation. SLT will work with CELC [4] to determine the extent of a capability gap across London Boroughs and support the determination of strategies and activities to close it.

Fiscal devolution in the London context will require the development of new forms of financial and political governance to manage and agree the distribution of resources across the city region. It is in the long-term interests of boroughs to contribute actively to the conception of these governance arrangements. Any new settlement has the potential to profoundly impact on the extent to which funding follows need and on the degree to which growth and other priorities are incentivised.

London Boroughs should individually and collectively energise and invigorate the debate, negotiation and conception of the financial and political governance implications of implementing the London Finance Commission (and other relevant proposals). SLT will work with London councils and the GLA[5] to develop robust financial governance proposals for London as a practical response to greater fiscal devolution. SLT also recommends that Government takes steps to ensure long-term stability and predictability in any devolution settlement with London and the rest of the country, particularly as it relates to growth incentives.

1 SLT: Society of London Treasurers
2 LGA: Local Government Association
3 CIPFA: Chartered Institute of Public Finance and Accountancy
4 CELC: Chief Executives' London Committee
5 GLA: Greater London Authority

Opportunities to promote economic growth, jobs and housing that would arise from investments funded by locally retained business rates and the removal of the HRA debt cap, throw into sharp relief the need for greater sub-regional working across London. It is highly unlikely that growth, infrastructure and significant housing opportunities will fall neatly into a 'whole of London' frame of reference or an individual borough boundary. In this context, given that prevailing proposals in London see the Mayor, GLA and London Enterprise Panel (LEP) as the principal regional governance tier for devolution, a failure to work sub-regionally could lead to boroughs individually and collectively being 'squeezed out' of key investment decisions. In turn this could lead to a depletion of their financial autonomy and sub-optimal outcomes for London as a whole. This is not a point about opposition to the GLA, rather that boroughs bring a closer proximity to their communities and a greater level of insight regarding local circumstance and opportunity. In this way, greater sub-regional working should be seen as means to discerning *more* growth in the Capital, not a tussle about power and the control of plans and schemes already in the pipeline.

SLT recommends that London Boroughs actively support implementation of the London Infrastructure Plan. They should use the process as an opportunity to define for themselves the sub-regional functional economic areas they believe makes most sense for them, their partners and London as a whole. SLT will actively work with the GLA to ensure that implementation of the plan continues to reflect the needs of London as whole, individual boroughs and relevant sub-regional functional economic areas.

London can learn from the experience of other regions and sub-regions when conceiving appropriate financial governance arrangements to support joint 'city deal' type working at a sub-regional level. Substantial sub-regional borrowing, investment, programme management and benefits distribution will require robust financial governance and this is in turn implies the need for decision making entities that can bear financial risk and be accountable for financial decision making. In Manchester, for example, this joint working is enabled through a Combined Authority arrangement. Under this agreement the sub-regional entity has responsibility for transport, economic redevelopment and regeneration functions on behalf of the ten constituent authorities. These authorities have been prepared to cede 'upwards' some powers in order to gain a greater collective share of devolution 'downwards'. Working in this, the Combined Authority makes all of the transport investment decision for the area and other decisions as agreed by the Manchester Mets'. To facilitate this, it has taken over responsibility for the transport assets and liabilities of the individual councils. It has also pooled transport funding to establish a £1.2bn programme, mostly to be funded through Prudential Borrowing, with an initial levy on the constituent authorities and the capture of future business rates income stream on an earn back basis. Combined Authority Arrangements are currently only available to authorities outside of Greater London. In other words, groups of London Boroughs are currently excluded from establishing Combined Authorities thus reducing their ability to conceive and execute investment opportunities at a sub-regional level.

SLT recommends that Government offers London Boroughs the opportunity to establish combined authority type arrangements of the kind available to other councils, including the ability, through these arrangements to negotiate their own city type deals.

1

Introduction : why this report and why now?

Local government prides itself on being the most efficient and effective part of the UK public sector. Since 2010 it has delivered savings in excess 25% while the satisfaction of its service users has increased for the majority of councils. From this perspective, local government is an exemplar of what can be achieved when public service decision-making is devolved and when strong, local, political and financial governance supports that devolution[6].

The sector has long argued that with a greater devolution of incentives and powers, councils could do more to support both deficit reduction and improved social outcomes locally, regionally and nationally. In particular:

- Saving money across the local public service economy by: driving greater strategic focus and coherence through disparately governed functions; service integration; and the removal of duplication.

- Leading local responses to mitigate the impact of austerity on the communities they serve. In particular: joined up responses to welfare reform; access to skills, training and jobs; and measures to grow local housing supply.

- Targeting substantial new investment to boost local and regional economic growth and wider business development.

This report focuses mainly on the latter opportunities, with a specific focus on the London context and particularly as those opportunities are illuminated and propagated by:

- The Heseltine Review 'No Stone Unturned: In Pursuit Of Growth' (October 2012) and the Government response (March 2013)
- The London Finance Commission (May 2013)
- The HM Treasury and Infrastructure UK report 'Investing In Britain's Future' (June 2013)
- BIS/CLG Guidance Report: 'Growth Deals, Initial Guidance for Local Enterprise Partnerships' (July 2013)
- The Mayor of London report '2020 Vision: The Greatest City on Earth' (June 2013)
- The Local Government Association (LGA) report 'Re-wiring public service' (June 2013)
- The Independent City Growth Commission (Launched October 2013 by the campaign for decentralised fiscal reform)
- The Independent Commission on Local Government Finance, launched by the LGA and CIPFA in June 2014
- The National Infrastructure Plan 2013 (Published December 2013)
- London Infrastructure Plan 2050 – Bigger and Better (Published July 2014)

6 For a comparison of the respective financial governance practice of Local Government and the NHS see Grant Thornton's report "Alternative Therapy – Strengthening NHS Financial Resilience" November 2013

The policy context for London is complex and evolving at a fast pace. The pressure for change is mounting, led amongst others by the Mayor of London, London Councils and the core cities. It is likely that the key principles and forms of devolution will be agreed with government and the political parties, one way or another, over the coming 12 to 18 months. Specifically: what will be promised in general election manifestos; and what assumptions will subsequently be carried forward when casting the 2016/17 CSR.

Now is the time to shape and influence the outcome of that debate. In this context, London treasurers have a distinctive voice and an important contribution to make. As section 151 officers it is our role to ensure that our respective authorities have in place arrangements for the proper administration of their financial affairs. If fiscal and wider financial devolution, of the kind envisaged by the various commissions, reports and lobbying voices, is to come to London then the impact on our prevailing norms of financial governance and patterns of financial sustainability will be profound and far reaching.

This report highlights what we see as being the key risks and opportunities associated with greater devolution in London, particularly as those changes impact financial decision-making, the management of financial risk and the task of medium to long term financial planning. It goes on to make recommendations about how these risks may be mitigated and the opportunities maximised.

Our starting point is to understand and then reflect upon the roles envisaged for individual London Boroughs under the various devolution scenarios currently being developed and negotiated. Our motivation is not born of inertia or parochialism. Nor is it concerned with power. It is principally practical. The vast majority of local government financial governance in London is currently managed at a borough level. It is at this level that: the big budgets are managed; financial risks appraised; and fiscal decisions taken. If this is to change, then careful attention needs to be paid to detail of the financial governance model or models to come. In other words we are posing the questions: is London, and by that we mean individual boroughs, boroughs collectively, and the GLA, ready to govern the money? And to the extent that we are not – what needs to happen next to ensure that we are?

2

Financial sustainability as a function of growth

In common with councils up and down the country, London Boroughs face the most challenging of financial contexts. Falling central government funding and rising demographic demand means that most of the capital's 32 authorities are planning to be spending 40-50% less on the provision of services at the end of this decade, compared with the start. In contrast to other parts of the public sector, local government has made an outstanding contribution to deficit reduction – reducing spend by over 25% since 2010 while preserving services and improving resident satisfaction. However, most councils, commentators and finance professionals share the view that on-going reductions of this magnitude are unsustainable and that at some juncture between now and 2020 many local authorities, including those in London, will be unable to meet their core statutory obligations; a notion first epitomised in the self-styled Barnet 'Graph of Doom' set out in figure 1 below.

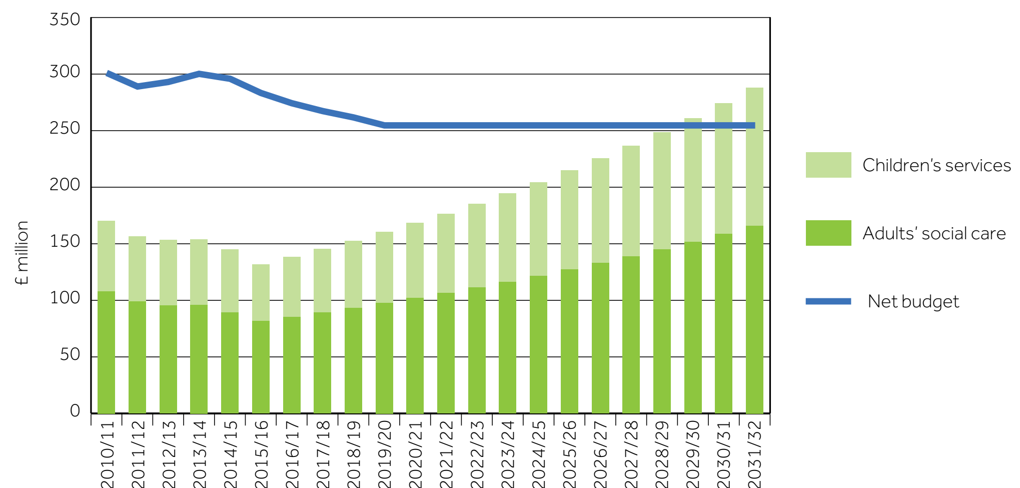


Figure 1: *The 'Barnet Graph of Doom' models the impact of funding reductions and demographic demand pressure to test the sustainability of council services over the medium term.*

The national economic and fiscal policy context offers little room for optimism. All major political parties are committed to deficit reduction strategies that aim to see the nation's books balanced by the end of the decade. Likewise, there appears to be no political appetite to significantly change the balance of spending cuts to tax rises. Applying these parameters to the total expenditure of government, and making allowance for money spent on pensions, welfare and debt interest (which are technically not 'managed' as departmental budgets) and then layering on top national political commitments to ring-fence health and schools spending, means central government will be looking to make savings of circa £75bn from a residual budget of just £100bn. Unfortunately for councils, their central government funding is contained within this £100bn unprotected pot.

Accordingly this context has required the local government sector to develop a new set of strategic responses. Chief amongst these have been calls for greater financial and fiscal devolution from central government to councils with two key aims:

- » **To enable a better join up and integration of services locally so that better outcomes can be achieved and spending 'across the system' reduced.** To date these opportunities have proved difficult to un-lock, not least because of the centralised governance, control, ring-fencing and funding of most locally provided services currently outside the scope of local government's remit.

- » **To stimulate *additional* economic growth through *locally discerned and targeted measures* as a means of increasing revenue to fund services, and also reducing costs associated with weaker economic performance.** In this way local economic development activity, led by councils in partnership with the private sector and central government, becomes a pivotal response to the fiscal challenge of austerity and forms a core element of the sector's medium to long term financial recovery plan. In this way, the 'Graph of Doom' makes way for the 'Graph of Boom'

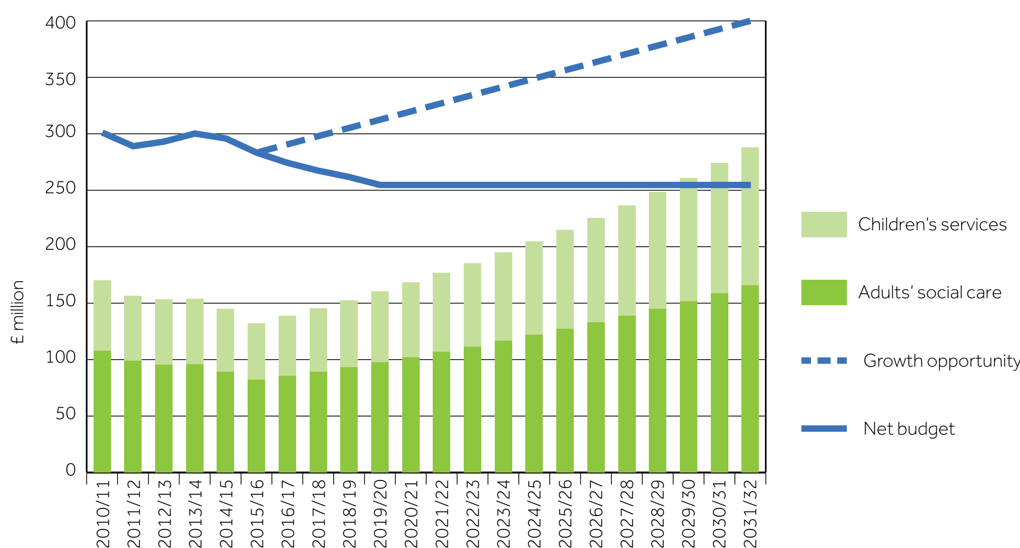


Figure 2: *The 'Graph of Boom': a more optimistic version of the future if locally stimulated economic growth could be captured and retained by the council.*

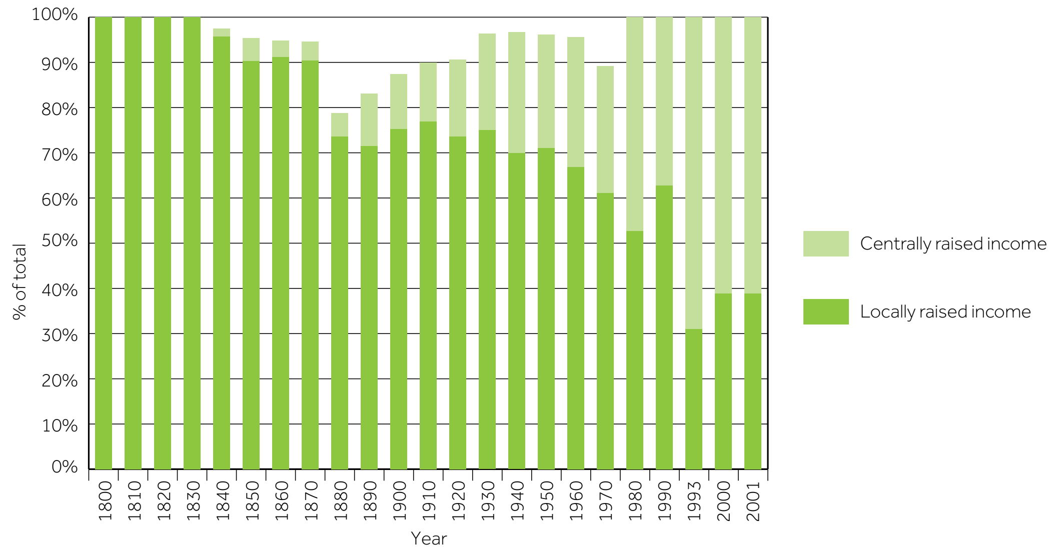
This report focuses on the implications of the second of these aims – the promotion of growth through greater financial devolution and in particular the impact of emerging devolution proposals in London. Many of the insights and conclusions will be relevant to the first aim too.

Historically, the dependence of councils on central funding has progressively increased (see figure 3 below). Amongst other things, this has had two key relevant consequences:

- » **Over time councils have had limited incentive to promote growth,** notwithstanding their potentially pivotal role. This means that most councils have less developed skills and capability of the kind needed to discern an economic growth strategy and then deliver it. It also means that many councils don't necessarily have a strong track of forming the kinds of meaningful partnerships with other authorities and with the private sector that are the prerequisite if growth projects are to succeed.

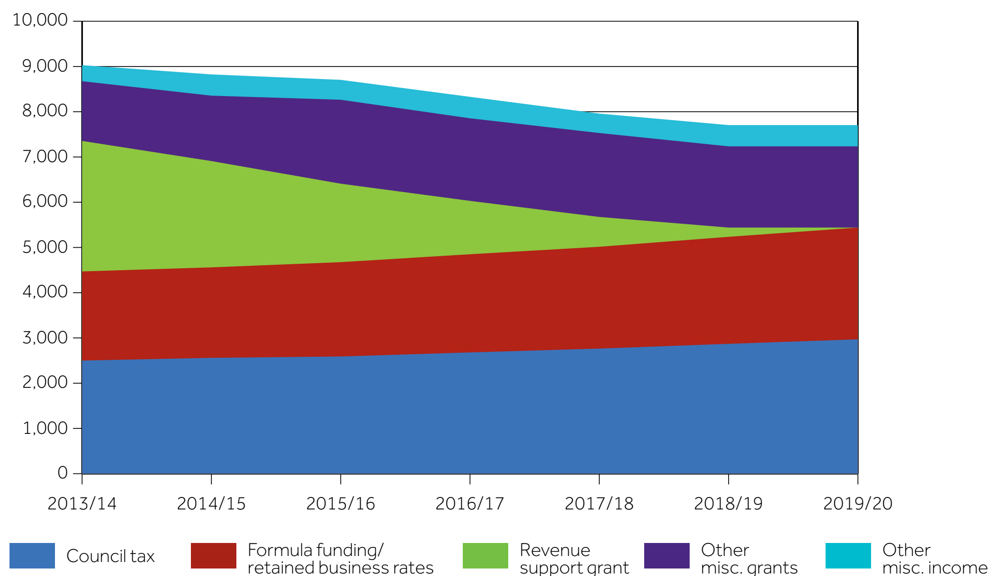
- » Second, **the sector's financial and political governance arrangements are not designed to manage the regional or sub regional management** of pooled investment (say, from prudential borrowing) or the distribution of pooled income, for example from a growing business rates base. Instead, prevailing arrangements have become 'expert' at governing decisions about expenditure and lobbying central government to mitigate risk in relation to the quantum and distribution of central funding through the revenue support grant.

Figure 3: *Central vs. local funding over time (Travers & Esposito, 2003)*



As fiscal austerity deepens, the historic trend is being pushed into reverse. Figure 4 below, shows that on current trajectory most London Boroughs will receive only a very small proportion of their funding from centrally controlled Revenue Support Grant by the end of the decade. This means that measures to boost business rate and council tax receipts and the capability to implement such measures, becomes critical to the financial sustainability of the boroughs. It also means that governance of decision making in relation to business rates at a national level (such as the timing of resets) and at a local and regional level (for example their application to fund investment borrowing) becomes a matter of supreme importance for councils planning their medium term financial strategies.

Figure 4 [7] *The decline of Revenue Support Grant and growing dependence on locally raised taxation in London.*



It is for all these reasons that proposals for devolution need to be considered through the prism of:

» Their propensity to help councils manage the significant reductions in funding they are experiencing, including, but not limited to the retention of the fiscal benefits of growth.

» The impact they have on councils individual and collective ability to stimulate growth including the requirement for new strategic skills and capability, and in terms of what those proposals mean for senior executive and political leadership.

» Their impact on prevailing financial governance arrangements.

7 Source: London Councils

With these considerations in mind, the remainder of this section summarises the key features of the emerging devolution proposals for London and offers some immediate observations for exploration in more detail in the sections that follow.

Heseltine report: 'No Stone Unturned: In Pursuit Of Growth' (October 2012) Proposed a round of sub-regional devolution to support 'functional-economic areas' with a particular focus outside London and the south east. There are strong signals throughout the report that London *as a whole* is seen as one such economic area. The report homes in on the mayoral structure as one of best practice, which leads the reader to assume that the London governance structure is perceived to require little change when compared to the position outside London. This view of London has set the scene for policy documents and propositions that have followed. Indeed the Government's response in March 2013 gives a strong sense that London has received support in the past and, although this will continue, the emphasis will now be given to flexibilities for authorities outside of London, particularly through City Deals, LEP initiatives and through the ability to create 'Combined Authorities'.

The London Finance Commission (May 2013) Brought together a range of evidence and analysis around finance devolution and made a number of key recommendations or 'asks' of government including:

» That the management and retention of property-based taxes should be devolved to and retained by councils in London. Specifically: council tax; stamp duty; capital gains tax; and business rates.

» The removal or revision of HRA caps to allow house building to take place at an accelerated pace.

These recommendations have percolated through to the wider national policy debate around finance devolution, being picked up by many councils and the Local Government Association as a key plank of the LGA's 'Rewiring Public Services' programme. They have also influenced the work programme of the recently established Independent Commissioning on Local Government Finance, chaired by Darra Singh.

The London Finance Commission acknowledged that implementation of its recommendations would require new governance arrangements across London though the report fell short of specifying what those arrangements should be.

The Mayor of London report '2020 Vision: The Greatest City on Earth' (June 2013) Echoes calls from the London Finance Commission and others to remove the HRA borrowing cap on local authorities. The report also provides support for the findings of the London Finance Commission, including devolution of property taxes – although crucially argues that devolution should broadly be to London as a whole rather than to individual boroughs.

BIS/CLG Guidance Report: 'Growth Deals, Initial guidance for local enterprise partnerships' (July 2013) The guidance recognises that the London Enterprise Panel is in a different situation from other LEPs due to the GLA and TFL funding structure. In particular the report noted "The Government will take forward more detailed discussions with the London Local Enterprise Partnership and Greater London Authority on the practicalities of the Local Growth Fund proposals in the *unique context of London*[8] ". Subsequently, with support from the Chancellor, the London LEP submitted a growth deal for London as part of the Growth Deal process, and as a result it was awarded £70m of New Homes Bonus monies, to be allocated to boroughs or groups of boroughs in a negotiated way to support delivery of the proposals. London councils worked closely with the GLA to support and influence this process, in particular inviting groups of boroughs to submit their own proposals to boost jobs, skills, competiveness, infrastructure and homes as a means of developing and strengthening the LEP's overall submission.

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8 Author's emphasis

The Local Government Association (LGA) report 'Re-wiring public service' (June 2013) The LGA Launched its Rewiring Public Services campaign in late June 2013. The lobbying approach has a number of aims, one of which is to "boost economic growth in a way that offers prosperity to every place". The report goes on to set out ten *big ideas* of which the three most relevant to this analysis are:

» Idea (1) "Give people back a meaningful local vote on a wide range of tax and spending decisions, to establish a level of decision-making that allows each place to act as its own local treasury, managing local tax and spending and driving growth"

» Idea (5) "Share money fairly around England by taking financial distribution out of the hands of ministers and replacing it with an agreement across English local government"

» Idea (7) "Boost investment in infrastructure by re-creating the thriving market in municipal bonds which England once had and most other countries still have"

The Independent City Growth Commission (Launched October 2013 by the campaign for decentralised fiscal reform) The Mayor of London, London councils and the core cities joined forces in September 2013 to collectively call for greater fiscal decentralisation and 'radical devolution'. In October 2013, the combined campaign established an independent City Growth Commission to investigate how England's cities can become engines for growth, ensuring that all regions are part of the UKs economic recovery. The inquiry includes an open call for evidence between the autumn of 2013 and summer of 2014. In particular, submissions are sought from businesses, the investor community and business groups, as well as from local government, think tanks and civil society organisations.

The Independent Commission on Local Government Finance was launched in June 2014 by the LGA, working with CIPFA, and builds on the momentum given by the LGA's Re-Wiring Public Services programme. It will focus on the following areas:

» Promoting economic growth and infrastructure
» Housing supply
» Health and social care integration
» Achieving a welfare system that promotes work and protects the vulnerable
» Supporting families and young people through early intervention

The Commission will publish its preliminary findings in autumn 2014, to be followed by a full report in early 2015 ahead of the General Election.

London Infrastructure Plan 2050 – Bigger and Better This GLA sponsored analysis , consequent of a specific recommendation in the London Finance Commission, ambitiously attempts to set out the major infrastructure needs of the capital over the next 36 years as its population and economy continues to grow. The plan also explores how this infrastructure will be funded and built and in so doing reinforces a number of the key conclusions in the Finance Commission report.

Given the diminishing resource position of most councils across the Country and London Boroughs in particular, it is clear that the right package of financial devolution measures, incentives and powers could have a significant positive impact on the medium to long term financial health of the sector.

However, while much progress has been made recently, it is also clear that much of the *detail* about how fiscal devolution would work in practice in London is still to be discerned and agreed. An obvious example of this being the governance of decisions about the distribution of devolved taxation in London as proposed by the London Finance Commission, the Mayor of London and the LGA. Should this be a matter for the Mayor, for the boroughs or a combination of the two? What form should this governance take? How will decisions be held to account and scrutinised by tax-payers and other interested parties?

Given the scale of financial pressures facing London Boroughs and the imminence of that challenge, now is not a time for councils in London to be passive and to 'wait and see' how these proposals develop and emerge. A failure to engage at this juncture could simply result in one manifestation of centralised decision making from Whitehall, being replaced by another from City Hall.

Likewise if increased fiscal devolution is to become a dominant feature of future financial planning, councils in London should critically assess their own skills and capability particularly in relation to the tasks of regeneration, housing and infrastructure development, economic analysis, insight, business case development and commercial negotiation. The fact that Government's commitment to devolution, growth incentives and tax retention to date has been, (some would argue) lacklustre and disappointing is not a reason for councils to respond with a failure of imagination or an unwillingness to persevere.

It is for these reasons that London Treasurers recommend that:

» London Boroughs should individually and collectively energise and invigorate the debate, negotiation and conception of the financial and political governance implications of implementing the London Finance Commission (and other relevant proposals). SLT will work with London councils and the GLA to develop robust financial governance proposals for London as a practical response to greater fiscal devolution. SLT also recommends that government takes steps to ensure the long-term stability and predictability in any devolution settlement with London and the rest of the Country, particularly as it relates to growth incentives.

» London Boroughs individually and collectively contribute to the Independent Commission on Local Government Finance, launched by the LGA and CIPFA. Boroughs should also determine the organisational development implications of greater finance devolution, including proposals to support new skills and capability: regeneration, housing and infrastructure development, economic analysis, insight, business case development and commercial negotiation. SLT will work with CELC to determine the extent of a capability gap across London Boroughs and support the determination of strategies and activities to close it.

3

Scaling the opportunity: the risk of being squeezed

> **"I have always believed that leadership is the key to success in any field. London already has such a leader, Liverpool and Leicester now too. These cities are pioneers from which we should learn."**
>
> *Lord Heseltine: 'No Stone Unturned: In Pursuit Of Growth'*

A striking feature of almost all the significant financial devolution proposals set out in section 2, is that the current London governance structure, centred around the Mayor and LEP with boroughs as 'second tier' is perceived by policy commentators and central government as 'best practice', successful and not requiring change. This view needs to be challenged.

It is self evident that opportunities to promote growth, boost employment, increase housing supply and execute contingent infrastructure, are unlikely to exist neatly at either the level of an individual borough or the whole of London. Indeed, many will originate at a sub-regional level and not always with partners comfortably bound within the M25. Amongst other things this is because of:

- The distribution of available land for development
- The capacity of existing infrastructure to support new homes and or business growth and the un-even distribution of this capacity across London (and the impact this has on individual council's ability to respond and influence change)
- Individual authority affordability issues in terms of borrowing headroom and medium term financial stability
- The capacity of individual authorities to deliver major capital schemes because of financial pump priming issues (for example funding business case development) and/or sufficiency of appropriately skilled human resource capability.

However from a London perspective, this is exactly how financial governance arrangements currently conspire to contain the scope of investment opportunities. **In other words our prevailing arrangements risk constraining London's ambition by seeking to govern them either at the granularity of a 1/32 perspective or a whole London perspective.** Accordingly, if the prevalent behaviour of central government towards London persists, there is a high risk that the London Boroughs will be squeezed out of decision making, particularly decisions about the prioritisation of those opportunities that exist at a sub-regional level. Worse still, perhaps, these opportunities will go unidentified and opportunities will be lost.

Arguably the squeeze is already evident. For example government has announced that for 2015/16, New Homes Bonus will be top-sliced from London Boroughs to provide funding for the London LEP. This follows the government's July 2013 guidance document "Growth Deals: Initial guidance for local enterprise partnerships" which included the noteworthy line "It is the government's intention that the London Local Enterprise Partnership can, if it wishes, negotiate a Growth Deal with the government and that any deal would need to reflect London's unique circumstances given the significant existing responsibilities of the Mayor and Greater London Authority". Subsequently the London LEP submitted a growth deal for London with a focus on welfare to work and skills, and housing investment and supply and as a result was awarded £70m

of New Homes Bonus monies. While the development of this proposal was supported by London councils and through groups of councils in London submitting their own propositions to the LEP, the fact remains that government's principal level of engagement is with the Mayor.

Likewise, the National Infrastructure Plan 2013, published in December 2013, refers to a number of projects in London that are receiving direct support from central government, over and above those previously announced for projects such as Crossrail. With the notable exception of the £1bn borrowing support for the Northern Line extension, none of the remaining £36bn of schemes originated from an individual borough, or a borough led sub-regional proposition. This is reinforced in the GLA's London Infrastructure Plan 2050, published in summer 2014, which again takes a pan-London view to investment and growth in infrastructure.

The risk of being squeezed is compounded when the magnitude of the financial capacity that could be released, were some of the freedoms being pushed by the London Finance Commission, is understood either from the perspective of an individual London Borough or London as a whole. For example, take just two of the 'asks' in the London Finance Commission: measures to unlock additional prudential borrowing (principally by capturing the return on investment through business rate retention); and the relaxation/removal of the HRA debt cap. Work commissioned by SLT and undertaken by Capita reveals that:

» Under current **prudential borrowing** arrangements, London as a whole has prudential borrowing headroom if it is able to 'capture' the future fiscal benefit of investment that subsequently delivers growth. With one or two notable exceptions, transformational impacts on the growth prospects of London come when that investment capacity is scaled either regionally or sub-regionally. The impact at an individual borough level is much more modest and consequently, far less transformative.

» The picture is even starker for the **removal of the Housing Revenue Account (HRA) cap**. The current HRA headroom across London is estimated at being between £1.2bn and £1.4bn. But this isn't distributed evenly across London, nor is there necessarily a correlation between headroom and capacity (space) to build. The London Assembly have already projected that London council housing stock assets could comfortably sustain a doubling of borrowing headroom if the borrowing cap were lifted. Taking the London Borough of Barnet as an example, the headroom is £40m. A doubling of this to £80m would of course be welcome to local policy makers; however, as with the prudential borrowing opportunity, the transformative impact comes with scale.

The key point of this analysis is to demonstrate that the public policy merit of devolution sees its most profound impact not at the borough level, but regionally and sub-regionally. In other words, the case for changes rests on the transformational impacts that come from substantial, yet targeted investments, not from increasing opportunities at a sub-division of 32. The risk for the boroughs is that under prevailing arrangements leadership of the 'scale opportunity' exists only with the Mayor/GLA/London LEP. Seen in this way there is a clear governance gap in London, the continuing absence of which reduces the individual and collective influence and control of the capital's 32 boroughs.

It is for these reasons that London Treasurers recommends that:

» London Boroughs actively contribute to the implementation of the London Infrastructure Plan. They should use the process as reason to define for themselves the sub-regional functional economic areas they believe makes most sense for them, their partners and London as a whole. SLT will actively work with the GLA to ensure that implementation of the infrastructure plan-continues to reflect the needs of London as whole, individual boroughs and relevant sub-regional functional economic areas. Spear headed by the GLA the plan has assembled an understanding of the infrastructure needs across London through to 2050. Implementation of the plan provides boroughs with the opportunity to demonstrate both their imagination to conceive sub-regional opportunities and their commitment to see them delivered. The counter point is that their failure to respond may lead to that regional or sub-regional vision being conceived by others and, at worst, effectively 'imposed'. This risk is particularly the case for a) infrastructure and investment in measures to promote growth b) measures to boost housing

supply. To avoid this risk London Boroughs need to carefully consider their capability and capacity to thoroughly understand, determine and evidence sub-regional requirements.

» **More generally, borough's leadership teams – political and managerial – need to recognise and appreciate the very real risk of being marginalised as devolution arrangements are finalised. They should act now to identify appropriate sub regional arrangements as a means of mitigation.** Given that real impact is achieved at scale, it follows that boroughs need to be able to participate at scale too. Failure to do so may see them being absent from the debate, missing out on finance devolution flexibilities and being too remote from the GLA initiatives that are put in place to respond. In practice this will mean their ability to invest locally may be reduced and decisions that effect their residents 'taken away from them' to be governed at a regional level. In response they should discern whether they are prepared to cede some power 'upwards', to be governed collectively at a sub-regional level, as mitigation against being calved out of devolution 'downwards' all together. This should be seen as part of wider process of earning greater autonomy from Whitehall.

4

Managing investment, income, risk and reward at a sub-regional level in London

Section 2 of this report highlighted how crucial incentives and returns from local economic growth could be for London Boroughs as they plan to manage the next round of austerity driven cuts. Section 3 went on to stress the likely significance of sub-regional working as a means of activating those growth opportunities in London. This section considers the financial governance implications of managing significant financial borrowing, investments and returns on a sub-regional basis.

Across London there already exist a number of well-established sub-regional partnerships or alliances that have provided the basis for arbitrating, prioritising, agreeing and then delivering inter-authority working. Examples include the West London Alliance, East London Solutions, and the Tri-Boroughs.

The question arises whether or not the governance arrangements that support these partnerships are robust enough and sufficient to manage the conception and deployment of significant long-term financial investments. The contention of this report is that they are not.

Transformative investments in infrastructure to support growth and housing supply often need be counted in the hundreds of millions and more often than not, billions of pounds. In the previous section of this report we noted the research undertaken by Capita for SLT and their conclusion that to achieve investments of this scale would require the pooling of borrowing. Managing large scale pooled borrowing on a shared basis throws up a number of immediate financial risks and issues that would need to be thoroughly bottomed out before any one individual or group of councils could countenance agreement to proceed. These issues would include:

- Ascertaining the degree of collective confidence in the investment business case;
- Agreeing the funding and payback model, seeking collective agreement to each individual authority's borrowing contribution and agreeing the ring fencing of tax returns to service and repay the debt;
- Determining who should take day-to-day responsibility for delivering the investment including accountabilities for programme management, ownership of risk, decisions about cash flow and use of contingencies and the procurement of investment partners and advisors.

Cohering agreement to these matters through multiple decision making process across a number of different councils could prove fiendishly difficult and would require an exceptionally high level of collective senior political and executive sponsorship over a sustained period of time. To exemplify the point, it is worth considering three specific and recent sub-regional growth opportunities in London.

Figure 5: *Exceptions that prove the rule in London*

Nine Elms and the Northern Line extension (NLE)

The London Boroughs of Wandsworth and Lambeth have concluded an agreement with both the GLA and TFL to fund a £1bn two stop extension of the Northern Line from Kennington to Battersea Power Station. The tube line extension allows for a much higher level of development both within and around the power station site which has been empty for 30 years. The extension is funded through a mix of Section 106 and community infrastructure levy payments, together with business rates growth. The funding is collected by the boroughs and paid to the GLA who will borrow against this income stream.The low level of council tax in Wandsworth in particular would have made borrowing by the boroughs particularly risky with only a marginal shortfall in year on year revenues potentially risking a one off increase in council tax and triggering a referendum. However , as the main cost risk is with the Mayor via TfL it is rational for the Mayor via the GLA to take the borrowing risk. The overall arrangement does mean that the NLE gets priority of funding over other infrastructure developments in the area but without it the power station would probably have remained empty.

Brent Cross and a new Thames Link Station

The London Borough of Barnet is currently working with the GLA and HM treasury to conclude a TIF type arrangement to ensure that the area surrounding Brent Cross shopping centre in the south west corner of the borough benefits from the forthcoming redevelopment of the retail site. Land to the south of the current shopping centre, in Barnet, but on the border with the London Borough of Camden has capacity for at least 7,000 new homes. However, due to poor transport links it is currently economically unviable to develop. Less than a mile away is the Thames Link railway line. A new station on this line, on a site in Barnet, but this time on the border with the London Borough of Brent would provide sufficient additional transport capacity to increase local land values, unlocking the development potential and enabling the rapid building of thousands of much needed new homes. In this example, the London Borough of Barnet is proposing to carry the financial risk, by borrowing the money to fund the new station and agreeing with government the retention of all new additional business from Brent Cross to fund and repay the loan. In this way the borough has governance oversight of both the debt and the income.

Imagine for a moment if, by quirk of history, the borough boundaries of Barnet, Camden and Brent were moved north and east respectively, such that the economically sub-viable land was in Camden, the location of the new station was in Brent, and the shopping centre was in Barnet. In this scenario the borrowing, funding, benefits and risk proposition would become instantly more complex unless the three boroughs in question were able to somehow pool and share risk through some form of shared financial governance. As with Nine Elms, currently the only realistic option in such situations would be for the GLA to step in to both borrow the money and service the debt.

West-London Alliance and the Growth Deal

The West London Alliance (WLA) is a sub-regional grouping of six London Boroughs: Barnet, Hounslow, Hillingdon, Ealing, Brent and Harrow. Serving a collective population of 1.8m and with a combined budget of £3.8bn per year, the Alliance has a high level of joint commitment to develop new ways of working together and delivering change across the sub-region.

The WLA has four key programme areas, including housing, transport, social care, and environmental issues. It is also heavily focused on broader policy relating to local growth, businesses development, and finding ways to retain and reinvest the benefits of growth.

In addition, in July 2014 the Alliance was awarded a portion of the £70m New Homes Bonus top slice to deliver a 'Mental Health and Employment Integration Trailblazer programme', which form a part of London's Growth Deal, with support from the Cabinet Office, JCP, and the DCLG.

Whilst the trailblazer programme is clearly a positive step in the right direction, it also highlights some of the inconsistencies faced by Alliance members as they work together ever more closely to meet the challenges of austerity. In particular the degree to which resources and decision making can be shared across boroughs, the extent to which the proceeds of growth such as New Homes Bonus monies and increases in business rates can be retained, and the limited ability to make decisions independently from the GLA or central government.

Greater fiscal freedom along the lines set out this this report would allow the WLA, as well as other groupings of councils, to build on its track record of delivery and high level of commitment to establish more formal working arrangements along the lines of those already piloted in other parts of the Country. It would also go a long way to incentivising greater collaboration and the development of the more formal governance, accountability, decision making, and delivery powers that will ultimately be required to deliver pan-London priorities effectively and efficiently in the future.

At this juncture it is worth reflecting on the experience of authorities outside London who have worked together to pool resources to deliver long-term infrastructure investment.

Greater Manchester

Perhaps the most fully worked up example is the Greater Manchester Combined Authority (GMCA). The GMCA is the first combined authority to be established in England for a city region. It is a statutory 'body corporate' with its functions set out in legislation. The GMCA includes functions that were previously overseen by the Greater Manchester Integrated Transport Authority plus some additional economic development and regeneration functions.

The combined authority is a legally recognised entity able to assume the role of an integrated transport authority and economic prosperity board. This gives the combined authority the power to exercise any function of its constituent councils that relates to economic development and regeneration and any functions that are available to integrated transport authorities.

The constitution of the GMCA is set out in an operating agreement that has been individually agreed by each of the member councils.

The combined authority's membership comprises the leaders of the ten constituent councils, with each responsible for a particular policy portfolio. Other leading politicians sit on various committees, ensuring greater buy-in and influence locally. The Local Enterprise Partnership is a key component of Greater Manchester's governance arrangements, ensuring that business leaders are empowered to help determine local economic priorities to drive growth and job creation within the city region.

The GMCA and LEP recently published the "Greater Manchester Strategy: stronger together" which has been developed around the twin themes of growth and reform. Building on an evidence base established through the Manchester Independent Economic Review and updated through the GM Integrated Assessment, the strategy sets out a series of strategic priorities to secure the sustainable economic growth of the conurbation and to enable the residents of Greater Manchester to access the progress through work. The aim is for Manchester to become a financially self sustaining city, closing the gap between the tax that is generated through growth and the cost of delivering public services.

Last year the combined authority secured a city deal with government, the first deal of its kind in the country. The deal sets out a range of bespoke agreements between the government and the GMCA relating to skills and local economy, a low carbon hub, business transport, trade and investment, housing and transport.

The Greater Manchester arrangement was specifically highlighted by the London Finance Commission as a model of how finance devolution can work, particularly homing in on the '**Earn Back**' deal that the city has agreed with central government. The Combined Authority has pooled transport funding to establish a £1.2bn programme, mostly to be funded through Prudential Borrowing, with an initial levy on the constituent authorities and future business rates income stream on an earn back basis.

The 'Earn Back' model is in effect a TIF arrangement and is being applied to transport infrastructure projects with the projected business rate growth that the constituent authorities are willing to back and fully intend to deliver.

South East Wales Transport Alliance

A different, slightly looser model of where councils are working together around finance issues is the South East Wales Transport Alliance (Sewta). This is a grouping of ten local authorities in South East Wales, which prepares and co-ordinates regional transport policies, plans and programmes on behalf of its constituent councils. Sewta came into being in 2003/04 when the previous local authority groupings of South Wales Integrated Fast Transit (SWIFT) and Transport Integration in the Gwent Economic Region (TIGER) were brought together to create Sewta.

The leadership of Sewta comprises of two members from each of the ten constituent authorities forming the board (normally including the Cabinet Member for transport), together with non-voting representatives from partners. The directorate, with officers from each council and the Welsh Assembly Government, provides senior management support for the board. The board and directorate meet quarterly.

The focus of Sewta is on advice about sub-regional infrastructure investments that cut across council boundaries, and which are of interest at a level below the devolved administration and on the integration of services.

The purpose of highlighting these examples is not necessarily to champion a particular one over another, merely to highlight how others are putting in place responses to mitigate the financial risk of shared borrowing and investment opportunities.

Substantial sub-regional borrowing, investment, programme management and benefits distribution will require robust financial governance and this is in turn implies the need for decision making arrangements that can make timely, accountable decisions and governance arrangements that can share risk. In Manchester this has been achieved through creating a new entity that can bear risk and be accountable for financial decision making. This in turn has been enabled through the development of a Combined Authority Arrangement and a corresponding City Deal.

Combined Authority Arrangements are currently only available to authorities outside of Greater London. In other words, groups of London Boroughs are currently excluded from establishing Combined Authorities thus reducing their ability to conceive and execute investment opportunities at a sub-regional level. This no doubt reflects some of the issues set out in section 2 and 3 of this report that the right tier of governance to establish City Deals in London is with the Mayor, GLA and London LEP. **For the reasons set out in this report, London Treasures argue that this may not always be the most optimal solution in London and accordingly SLT recommend that councils in London lobby hard to ensure boroughs have access to the same freedoms and flexibilities that are enjoyed by other authorities across the country.**

5

Conclusion: facing the future together

London Boroughs face on-going financial challenges brought about by fiscal austerity and national government's approach to deficit reduction. Austerity, coupled with demographic pressure means that most London Boroughs are planning to be spending 40-50% less by the end of this decade compared to the start. It is unlikely that such reductions will be sustainable.

In this context, fiscal devolution that incentivises growth and which enables the retention of the product of growth provides one of the few opportunities to help square the circle. Accordingly this report welcomes all efforts and propositions that allow London Boroughs, the Mayor and wider GLA family to work together to grow the London economy and collectively identify innovative solutions that close London's local government budget gap.

All the observations and recommendations in this report are intended to enable growth proposals that might otherwise be lost to London and lost to the UK economy as a whole. In other words, this is not a zero sum game. Our recommendations are about maximising growth potential, not an argument about the distribution of a fixed sum. To this end:

We argue that:

» **London Boroughs should:**
- Actively contribute to the implementation of the emerging London Infrastructure Plan. **They should use the process to define for themselves the sub-regional functional economic areas they believe makes most sense for them, their partners and London as a whole.**
- Determine the organisational development implications of greater finance devolution. Including proposals to support **new skills and capability: regeneration, housing and infrastructure development, economic analysis, insight, business case development and commercial negotiation.**
- Individually and collectively energise and invigorate the debate, negotiation and conception of the financial and political governance implications of implementing the London Finance Commission (and other relevant proposals).

» **Government should:**
- Offer London Boroughs the opportunity to establish combined authority type arrangements of the kind available to other councils, including the ability, through these arrangements to negotiate their own city deals

About

The Society of London Treasurers consists of the 33 Section 151 officers of the London boroughs and the City of London, together with representatives of the functional bodies of the GLA family. The Society advocates on technical financial matters effecting London and its residents. The view represented by the Society reflects the professional views of its members and not the political views of any or all of their employing authorities.

This report has been written by Chris Naylor, chief operating officer and director of finance at the London Borough of Barnet, with support from member colleagues of SLT.

About Re

RE (Regional Enterprise) Ltd, or Re, is the new joint venture between London Borough of Barnet and Capita plc. Re provides a range of development and regulatory services to residents in Barnet and the south east of England.

The following services are provided by Re:

- Planning and development management
- Building control
- Land charges
- Environmental health
- Trading standards and licensing
- Cemetery and crematorium
- Highways
- Regeneration
- Strategic planning