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BRIEFING PAPER NOVEMBER 2015

FUTURE OF THE GREEN INVESTMENT BANK
ENVIRONMENTAL AUDIT COMMITTEE WRITTEN EVIDENCE

Summary & Recommendations

1. **Green Investment Bank (GIB) Purpose:** The GIB was set up to "*address specific market failures and investment barriers in a way that will achieve emission reductions at least cost to taxpayers and consumers*."[1] The Government has not provided evidence on the impact of GIB privatisation on the costs to energy consumers and taxpayers.

   ➔ *Question: Has the Government undertaken an impact assessment on GIB privatisation?*
   ➔ *Question: What is the impact of GIB privatisation on costs to the consumer and taxpayer of delivering the required level of investment in the UK Green Economy?*
   ➔ *Question: Has the Government undertaken an Environmental Impact Assessment on GIB privatisation?*
   ➔ *The Government must address the following questions. How will any future GIB:*
   - *Retain its **purpose for, and focus on, overcoming market failures** affecting financing of the UK's smart, green infrastructure;*
   - *Operate to **open major <u>new</u> investment options for investors** in the UK's low carbon economy while making a material contribution to decarbonisation;*
   - *Maximise the **deployment of equity and debt capital from EU sources** such as the European Fund for Strategic Investment;*
   - *Support the **UK's cities, regions and nations** in creating robust low carbon economies.*

2. **Best value for money for the taxpayer**: The Government has stated that it will only proceed with sale of the Green Investment Bank (GIB) when it is able to **achieve best value for money for the taxpayer**.[2] The evidence suggests that sale

[1] Green Investment Bank Commission Report, 2010, pxiii
[2] 'Future of the Green Investment Bank PLC' Policy Statement, Nov 2015, p17

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of the GIB at this time will not achieve best value for money: recent changes in policy have seen investor confidence in the UK green economy dip to an all time low[3]; the Energy and Climate Change Secretary's 'energy policy reset' speech[4] has confirmed that policy uncertainty in the sector will continue as key decisions are delayed into next year.

➔ *A rushed privatisation of either a minority or a majority share of the GIB in the current climate is highly unlikely to deliver best value for money for the taxpayer.*

3. **Lack of clarity on form of privatisation:** Government policy positions have not clarified what form GIB privatisation could or will take and why. Many questions remain outstanding. Is the Government selling the team? Is it selling the assets? Will GIB be sold as a bank? Will it be sold as funds? What evidence has or will inform these decisions? What options have been considered, dismissed and why? The answers to these questions will have a substantial bearing on whether a future GIB can fulfil its original aims and purposes.

   ➔ *The Government must provide clarity on what it means by "privatising the GIB", and how different models of privatisation will contribute to, or negate, the GIB's aims and purposes.*

4. **Making the case:** The Government has failed to make a compelling case explaining the rationale behind, or consequences of, its decision to sell a majority share of the GIB. Its positions on GIB recapitalisation, state aid, balance sheet treatment, crowding out private investors and security of original purposes are ambiguous, at times conflicting, and made without reference to evidence. There has not been any consultation on these plans or alternative options.

   ➔ *The Government must **provide evidence** to support assertions that: (a) a publicly owned GIB is no longer needed; (b) a privatised GIB will continue to fulfil its purpose of addressing market failures in the green economy and thereby deliver the scale of investment required; (c) GIB will not crowd out private investors; and (d) removal of all GIB legislative provisions are necessary to achieve balance sheet reclassification.*
   ➔ *The Government must take time to **effectively consult** industry, civil society, Devolved Administrations and city leaders on alternative options before rushing through privatisation and in the meantime **withdraw its amendments from the Enterprise Bill 2015**.*
   ➔ *Before continuing with privatisation plans, the Government must set out how the gap in financing for the low carbon economy will be bridged and how market failures will be addressed in the absence of a publicly owned GIB.*

[3] [3] http://www.ey.com/Publication/vwLUAssets/RECAI-45-September-15-LR/$FILE/RECAI_45_Sept_15_LR.pdf#page=35
[4] https://www.gov.uk/government/speeches/amber-rudds-speech-on-a-new-direction-for-uk-energy-policy

5. **There are alternative ways to recapitalise the GIB**: The Government has not shown any evidence that it has considered alternative approaches to recapitalising the GIB. We have set out a range of options below.

   ➔ *The Government must seriously consider alternative forms of GIB recapitalisation and provide evidence-based reasoning for why these options are not being taken forward.*

6. **It is our view that a majority public owned GIB is still needed:** The market failures in the UK low carbon economy remain and these continue to prevent the scale of investment required. A government intervention such as creating a GIB was and is needed because if left to the private sector alone green investing will remain ad hoc, focus too heavily on low risk, high maturity sectors and will remain the domain of small sized investment funds.

   ➔ *It is our view that the GIB should be majority public owned, with public ownership spread between Central Government, Devolved Administrations and Cities, and that it should be recapitalised from a variety of sources including institutional, citizen and European finance, with foundations in a reformed statute which maintains the green purposes but removes the Secretary of State veto to allow the GIB to operate off Government balance sheet.*

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Introduction

The Green Investment Bank has been a huge success story. As constituted, it had and continues to have wide cross-party support, support from civil society and most importantly support from the private sector. **This broad based consensus came following three years and two official rounds of rigorous market testing and evidence gathering to establish whether a green investment bank (GIB) was needed, and to collect evidence to inform its aims, design and operating model.** This was undertaken by the independent Green Investment Bank Commission (GIBC) in the first phase and then by Government following the 2010 general election.

To date the GIB has been a core investor in the UK's green economy. It has provided 25% of the capital and has been in 50% of all deals within its operational space. The Bank has played a key role in getting transformational projects off the ground that would have either been too complex or perceived as too risky to attract private investors alone. For example, the first of its kind Dong Energy Westernmost Rough Offshore Wind project and the complex financing of non-domestic energy efficiency projects in NHS Energy Centres[5]. As a result, the GIB has established itself as a unique market player, helping to drive **forward complex but high value infrastructure projects that would not have happened otherwise, accelerating cost reductions and delivering supply chain benefits in the UK.**

As such, Government GIB privatisation announcements have provoked a great deal of concern from across the political spectrum in Parliament[6], from the Scottish Administration[7], from civil society and importantly, from investors and industry. Industry experts have publicly stated that privatisation could undermine the unique function of the GIB and result in it crowding out rather than facilitating private capital[8]. As Bob Wigley, former Chair of the Green Investment Bank Commission pointed out at the Aldersgate Group Public Meeting on the GIB[9] "there is an inherent tension" between the GIB continuing to invest in novel, more complex projects that are profitable over the long-term versus shareholder pressure to maximise short-term returns on high value investments given their focus on quarterly performance.

Original Purposes

It is vital that any plans for the future of the Green Investment Bank (GIB) be tested against the purposes for which it was set up. **Despite the Government's recent repeated framing, the purpose of the GIB is not to 'prove that green is profitable'. That has long been proven.** It is to:

[5] Please see Annex A for 2 examples provided by Industry Experts at the Aldersgate Group Public Meeting on Future of the GIB

[6] A cross-party group of MPS (Conservative, Labour, SNP, Liberal Democrat and Green) joined together to call for a Westminster Hall debate on the Future of GIB to express their concerns.

[7] **http://www.ft.com/cms/s/0/0ae876b8-74d7-11e5-8564-b4bb9a521c63.html#axzz3rwLpPsfo**

[8] Aldersgate Group Public Meeting: 'Three Years of the GIB; What Next', Hogan Lovells, Tuesday 20 October 2015

[9] Ibid

- **Risk share between the public and private sectors;**
- **Identify and address market failures** limiting private investment in low carbon infrastructure; and thereby
- Accelerate and deliver green **investment at large scale and with significantly lower cost of capital**. [10]

Following detailed evidence gathering and market-testing, the GIBC, an independent and non-partisan advisory group brought together by the Chancellor, recommended the establishment of a GIB "*to support delivery of the UK's emission reduction targets as set by the Climate Change Act 2008. The support should be based on a public-private investment model and **address specific market failures and investment barriers in a way that will achieve emission reductions at least cost to taxpayers and consumers**.*"[11]

The GIBC found that without a way of directly addressing market failure and risk-sharing between the public and private sector through a GIB, **higher levels of direct subsidy would be required to facilitate investment which would therefore mean higher costs to the consumer and taxpayer.** GIB was therefore set up to work "*as part of overall Government policy to open up flows of investment by mitigating and better managing risk (rather than simply increasing reward to investors)*".[12] **Without a GIB, it was found that the consumer and taxpayer would have to pay more for the investment required.**

We have seen many changes to policy support for the green economy in recent months. This is affecting investor confidence, as set out below. **To privatise the institution that was created to risk share with the private sector will do further damage to investor confidence, which in turn raises the cost of capital for projects.** The Government has not provided any evidence on what the impact of GIB privatisation will be on the energy consumer and the taxpayer.

- ➔ *Question: Has the Government undertaken an impact assessment on GIB privatisation?*
- ➔ *Question: What is the impact of GIB privatisation on costs to the consumer and taxpayer of delivering the required level of investment in the UK Green Economy?*
- ➔ *Question: Has the Government undertaken an Environmental Impact Assessment on GIB privatisation?*

The Government has still not provided any clarity on how the privatisation is to take place or any evidence that a privatised GIB will be able to fulfil its functions. Government policy positions have not clarified what form GIB privatisation could or will take, or why that form is most appropriate. Many questions remain outstanding. Is the Government selling the team? Is it selling the assets? Will GIB be sold as a bank?

[10] 'Unlocking investment to deliver Britain's low carbon future; Report by the Green Investment Bank Commission', 2010,

[11] Green Investment Bank Commission Report, 2010, pxiii

[12] Green Investment Bank Commission Report, 2010, pxiii

Will it be sold as funds? What evidence has or will inform these decisions? What options have been considered, dismissed and why? The answers to these questions will have a substantial bearing on whether a future GIB can fulfil its aims and purposes.

- ➔ *The Government must provide clarity on what it means by privatising the GIB, and how different models of privatisation will contribute to, or negate, the GIB's aims and purposes.*
- ➔ *The Government must address the following questions. How will any future GIB:*
  - *Retain its **purpose for, and focus on, overcoming market failures** affecting financing of the UK's smart, green infrastructure*
  - *Operate to **open major <u>new</u> investment options for investors** in the UK's low carbon economy while making a material contribution to decarbonisation;*
  - *Maximise the **deployment of equity and debt capital from EU sources** such as the European Fund for Strategic Investment;*
  - *Support the **UK's cities, regions and nations** in creating robust low carbon economies.*

Plans to privatise the GIB did not appear in the Conservative Party manifesto and there has not been any consultation with Parliament, industry, civil society or the Devolved Administrations in advance of this change. **It is very surprising that an institution born of very detailed and rigorous consultation, evidence gathering and market testing which carries a broad consensus across political parties, civil society and industry, could be fundamentally changed without wider consideration and consultation**.

- ➔ *The Government should pause plans and consult widely – including with industry, civil society and Devolved Administrations – on whether privatisation at this time is the best route for the GIB and alternative approaches to GIB recapitalisation.*

The need for a publicly backed GIB

The Green Investment Bank is not a grant making institution. It is an institution which invests in projects that are commercially sound. However, as a public bank, it is able to engage with commercially sound projects in a way that most private investors cannot for the following reasons:

> Its mandate is to address market failures in the UK's green economy. It therefore seeks out the **more complex and difficult transactions that do not ordinarily attract mainstream private sector investors**. In pursuing these projects, it is able to reduce the risk for mainstream private capital and thereby attract co-

investment. This is how the GIB has leveraged £3 of private investment into the UK economy for every £1 of public money it has spent.

> The GIB's public mandate allows for its investments to consider long-termism, take on more risks and fill gaps in the market where other investors have not or could not go in the past. As a result, GIB has established itself as a unique market player, helping to:
  - drive forward difficult infrastructure projects, which would not have happened otherwise; and
  - accelerate cost reductions and deliver supply chain benefits in the UK.

This underlines the real value add of the GIB which is not simply based on the amount of its own capital it brings to the market, but the nature of that capital. Its mandate to address market failure means the GIB helps get projects off the ground that have been too complex to attract mainstream private investors. Furthermore, GIB capital is, by its nature, unstructured which means it is flexible enough to plug a wide range of financing gaps, while traditional investors are limited due to the restrictions on the type of risk each can undertake[13].

The need for a publicly-backed GIB continues. The UK must deliver around £750bn in new low carbon infrastructure and supply chain investment by 2025; there is significant appetite among institutional investors for low carbon investment opportunities; and there continue to be market-failures which stand in the way of achieving the scale of private investment required to meet our infrastructure needs. **There is therefore a continued need for these market failures to be addressed in order to deliver Britain's low carbon future at least cost and with maximum impact**.

We are particularly concerned to hear the suggestion by GIB CEO Sean Kingsbury at the EAC evidence session that when privatised, he would look at removing members of his Energy Efficiency team in order to furnish new areas of GIB focus. This serves to increase fears that a privatised GIB will not continue to address market failures in the UK green economy.

➔ *The Government must clearly set out the evidence for why it believes that market failures in the UK's low carbon economy no longer need to be addressed.*

Benefits claimed by the Government

The Government has failed to make a compelling case explaining the rationale behind, or consequences of, its decision to sell a majority share of the GIB. The stated positions on State Aid rules, GIB recapitalisation, balance sheet treatment, and security of original purposes are ambiguous, at times conflicting, and made without

[13] For example, Private Equity funds will take limited technology risk but will take project development risk and some market adoption risk, and traditional Infrastructure funds take no technology or development risk but will generally take construction and operation risk. These forms of capital are therefore not as nimble and dynamic as the capital currently available to the GIB.

reference to sufficient evidence. There has not been any consultation on these plans or alternative options put forward. **We highlight two of these areas in more detail below: State Aid and GIB Recapitalisation.**

On security of GIB purposes, we are not comforted by the Government's assertion that there is a commercial case for retaining these purposes. As we set out above, the original purpose of GIB was not simply to invest in green projects, it was to tackle market failures existing in the low carbon economy. The Government does not address this concern in its most recent policy paper. We remain unconvinced that the Government must repeal all the GIB provisions to move the GIB off balance sheet. We understand that removal of the Secretary of State veto on changes to the Articles of Association is the primary provision which requires repeal. This should not necessarily extend to the Green Purposes.

State Aid

The Government has stated that privatisation will 'free' the GIB from State Aid rules. This argument is a red herring and confirms that the fundamental nature and purposes of the GIB are set to change upon privatisation.

As highlighted above, the purpose of the GIB is to address market failures in the UK green economy. **State Aid rules are there to ensure that state-backed enterprises do not unnecessarily distort or interfere with the market and crowd out private investors**. Given the GIB's focus is to address market failure, State Aid rules do not in fact hinder its mission. To the extent that they are restrictive, they are in fact maintaining the GIB's focus on its original mandate. If State Aid rules did not apply to GIB, it would be in a position to undertake activities which are not aimed at addressing market failures and therefore activities which are highly likely to crowd out rather than crowd in private investment.

Furthermore, in a decision by the European Commission last week, the GIB has been granted scope to operate with aided capital for an additional 18 months and invest in some additional parts of the UK green economy.[14] This decision should be welcomed by the Government as it provides further space for pause to consider the evidence and alternative options carefully.

- ➔ *The Government must provide evidence to support its assertion that the GIB will not crowd-out private investment under its planned sell-off.*
- ➔ *The Government should explain how last week's European Commission decision alters its case for privatisation.*

[14] http://www.businessgreen.com/bg/news/2434995/eu-eases-rules-governing-green-investment-bank-lending

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Recapitalisation

The GIB does need access to a larger capital base in order to increase its impact. While the Government has framed privatisation as the only route to achieving this, there exist a whole range of other options which must be effectively explored.

A different approach is set out below. We have shared this with the Secretary of State for Business. **This approach recognises limits existing in the current fiscal climate while ameliorating industry concerns and providing a path to broadening the GIB's capital base while maintaining its public mission.** In addition, this approach provides co-benefits to the broader UK Government agenda on delivering the UK's long-term infrastructure needs, harnessing UK Pension Fund capital, Devolution and ensuring the UK accesses its fair share of European Funds.

There are several different potential routes to recapitalising the GIB. In 2016/17, the GIB should be focused on accessing the European Fund for Strategic Investment (EFSI) for British Infrastructure projects while exploring different models of recapitalisation that are a good fit with continuing to deliver on the Bank's original aim and purpose. These could include investment by UK pension funds and green ISAs, EIB investment amongst others. In this way there could be a phased approach to recapitalisation.

Bridge Funding: The European Fund for Strategic Investment (EFSI)

The EFSI is a public-private risk-sharing fund that forms a key part of the EU's 'Investment Plan for Europe'. Consisting of €21bn in public financing, it aims to mobilise at least €315 billion of additional investment in Infrastructure and SMEs in Europe over 3 years. All government contributions to the EFSI are classified as off balance sheet. While the UK has made £6 billion of UK guarantees available to match fund EFSI infrastructure projects in the UK, there is currently no effective intermediary within the UK to help British projects access these funds.

Recapitalisation sources

- ***UK Based Institutional Investors***

There is significant appetite among institutional investors for 'pound-denominated' low carbon investment opportunities. For example, in October, the £2.9bn Environment Agency Pension Fund announced it is pulling out of fossil fuel investment and is seeking to reallocate that capital (£450m) in to low carbon and energy-efficient investments. It is noteworthy that the Fund's Chief Investment Officer stated that the goal of investing £450m into low carbon and energy efficient investment "will be most difficult to achieve".

The GIB can provide solutions on two fronts. Firstly, direct investment in the GIB through an equity stake or purchase of GIB bonds would be attractive opportunities to the EAPF and other investors to consider. Secondly, the GIB is a ready-made vehicle to facilitate the Chancellor's plans for 6 'British Wealth Funds' to invest in regional infrastructure.

- ***Citizen Finance through GIB ISAs***

The Conservative party proposed Green ISAs in 2008. These were very popular with well developed proposals on how these could be effectively delivered. Citizen finance can make projects significantly cheaper to fund while diversifying the GIB's sources of capital. In Germany, citizen investors are willing to accept up to 3 percentage point lower returns on equity than traditional investment. Traditional profit-driven equity investors have an equity hurdle rate of 7-9%, whereas citizen investors may be satisfied with 4-6% because their motivations are not primarily financial[15]. Given the capital intensive nature of most low carbon investments, scaling up citizen finance has potential to make the delivery of large scale infrastructure more affordable, while democratising the gains from investments.

- ***Devolved Shareholding***

The Green Investment Bank invests across the UK. It would be consistent with Government Devolution agenda to accelerate that process by expanding the GIB shareholding structure to encompass Devolved Administrations – including Cities – thereby reducing central government shareholding (and 'control') and ensuring that British cities, regions and nations are effectively represented in creating robust low carbon economies.

- ***European Investment Bank***

A direct equity investment from the European Investment Bank was considered at the GIB's inception and could provide a means of maintaining the benefits attached to a publicly backed Bank while not impinging on the Government balance sheet. The European Investment Bank provides finance and expertise for sustainable investment projects and invests in large infrastructure projects alongside private investors. Low carbon energy and infrastructure investment remains a priority for the Bank.

Value for Money for the Taxpayer

The Government has stated that it will only proceed with sale of the Green Investment Bank (GIB) when it is able to **achieve best value for money for the taxpayer**.[16] Sale of the GIB at this time will not achieve best value for money for the taxpayer. Investor confidence in the UK green economy is at an all time low. The

[15] The German Institute of Economic Research
http://www.diw.de/documents/publikationen/73/diw_01.c.466289.de/dp1387.pdf

[16] 'Future of the Green Investment Bank PLC' Policy Statement, Nov 2015, p17

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Energy and Climate Change Secretary's 'energy policy reset' speech has perpetuated this uncertainty.

The Energy and Climate Change Secretary's 'reset' came following the "*unravelling*" of UK energy policy, which has "*left investors wondering what the Government is actually trying to achieve and what evidence, if any, is being used to inform current policy.*[17]" This has included policies reversing support for renewable energy technology and tax exemptions for low carbon vehicles, to the privatisation of the Green Investment Bank and the scrapping of the Green Deal. However, policy risk remains high, particularly on offshore wind – a sector where GIB is particularly highly exposed (59% of total GIB investment and 84% of 2015 GIB investments are in offshore wind). Particular policy risks affecting offshore wind following the 'energy policy reset' include:

> risk to availability of CfD in next three licensing rounds (to 2020) – uncertainty as to whether offshore wind will receive a share in 3 CfD auctioning rounds in this Parliament;

> risk of inadequate financing for CfDs beyond 2020 – uncertainty of Levy Control Framework rates beyond 2020;

> risk of no public financing beyond 2025 (within ROI period for pipeline projects); and

> risk to security of grandfathering of existing contracts (precedent set by FiT and onshore RO);

The damage to investor confidence has been substantial. The UK has tumbled out of Ernst & Young's top 10 most attractive countries for renewable investment[18]. CBI Director General John Cridland has warned that UK companies will lose out on hundreds of billions of pounds in opportunities for overseas exports[19]. Industry heavy weights have lamented the chaos of recent months, including Siemens– one of the world's biggest industrial conglomerates – stating "*doubt and uncertainty discourages investment decisions.*"[20] Ernst and Young have warned that the lack of rationale or clear intent behind these policies has "*the power to sour the UK's attractiveness as an investment destination more broadly*."[21]

In these circumstances, it is absolutely crucial that the Government does not rush through a GIB sale. A rushed privatisation of either a minority or a majority share of the GIB in the current climate is highly unlikely to deliver best value for money for the taxpayer.

[17] http://www.ey.com/Publication/vwLUAssets/RECAI-45-September-15-LR/$FILE/RECAI_45_Sept_15_LR.pdf#page=35
[18] Ibid.
[19] http://www.theguardian.com/environment/2015/sep/22/cbi-chief-lambasts-government-approach-to-green-economy
[20] http://www.ft.com/cms/s/0/139a29d2-36cf-11e5-bdbb-35e55cbae175.html#axzz3rwLpPsfo
[21] http://www.ey.com/Publication/vwLUAssets/RECAI-45-September-15-LR/$FILE/RECAI_45_Sept_15_LR.pdf#page=35

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ANNEX A – EXAMPLES OF GIB ACTIVITY ON COMPLEX PROJECTS[22]

The Dong Energy Westernmost Rough Offshore Wind

This project was the first large scale application of the new Siemens 6MW turbine, which is significantly more efficient and more suited to the marine environment than previous turbines deployed to date. This project will help accelerate cost reductions in offshore wind (which has already seen an 11% fall in costs in the last 4 years) but also has supply chain benefits as the turbines are those that Siemens will manufacture in Hull. The GIB took a 50% stake in this project in 2014. This project would not have taken off through the sole involvement of private investors. **http://www.greeninvestmentbank.com/news-and-insight/2014/uk-green-investment-bank-invests-461m-in-the-uk-offshore-wind-sector/**

Joint investments with Aviva Investors in NHS Energy Centres

The GIB made 4 joint investments in these NHS energy centres. This included the £18m investment in the £36m energy centre project at NHS Cambridge University Hospital.

The project was very complex and is representative of the market failure affecting the financing of non-domestic energy efficiency projects. It required the installation of a combined heat and power unit, biomass boiler, efficient dual fuel boilers and heat recovery from medical incineration. The project will allow a saving of £20m on the hospital's energy bill over the 25 year project (good for government spending) and an annual reduction of 25,000 tonnes of CO_2 (again, good for government spending if one takes into account future increases in carbon prices). **http://www.greeninvestmentbank.com/news-and-insight/2013/gib-provides-funding-of-18m-for-one-of-the-uk-s-largest-nhs-energy-centres/**

About E3G

E3G is an independent, non-profit organisation operating in the public interest to accelerate the global transition to sustainable development. E3G CEO and Directors were involved in the original design and market testing for the GIB.

E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

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[22] *Examples provided by Industry Experts at the Aldersgate Group Public Meeting, held at Hogan Lovells on 20 October 2015*