UK Infrastructure Bank strategic plan discussion paper
GIIA response
Friday 25th February

Introduction to GIIA

GIIA is the membership body for the world's leading investors in infrastructure, and advisors to the sector, who collectively represent US$1 trillion of infrastructure assets under management across 66 countries with one third of those assets in the UK. Our members are investing today to provide the smart, sustainable, and innovative infrastructure needed for our communities and economies to thrive.

The investor member base of GIIA is diverse and ranges from fund managers, pension funds, insurers, corporate investors, and sovereign wealth funds (a list of GIIA members can be found at http://giia.net/membership).

In the UK, GIIA members are responsible for:

- £27bn invested in 158 energy and renewables assets.
- 16.2GW of installed capacity across a 210,000 km electricity and gas distribution network.
- Producing 37% of the UK's entire renewable energy capacity.
- Major investments in 17 of the UK's largest 20 airports, which account for 94.4% of total passengers.
- Supporting almost 120,000 jobs in the nation's privately owned ports.
- Supplying 2/3 of UK household's water needs.
- Providing an additional 14 million households with full fibre internet while continuing to invest in 5G technology.

In addition to these vital sources of foreign direct investment, our research shows that more than 8.5 million UK pension pots are invested in UK national infrastructure via specialist infrastructure funds, helping to deliver a stable return for UK citizens in their retirement. In transport, renewables, utilities, digital and social infrastructure, GIIA members are investing across the UK to deliver the infrastructure needs of UK citizens and supporting the wider economy.

In relation to the UK Infrastructure Bank discussion paper: 'potential private sector opportunities in priority sectors', we are keen to provide the perspective of institutional investors in infrastructure. This response therefore acts as a high-level position statement on behalf of the institutional investor community on the issues raised in the paper and associated questions for stakeholders.

Crowding in

Recent investments by the UK Infrastructure Bank have been welcome and support the Bank's twin objectives of helping to tackle climate change and supporting local and regional economic growth. Experience of GIIA members participating within these investments has been positive and feedback has been received by our members that Bank colleagues have been readily

available, knowledgeable and have responded quickly and adeptly to communications from investors. It is also encouraging to see that the discussion paper clearly prioritises providing additionality in the market and is clear on the Bank's investment mandate to *crowd-in* private capital investment above and beyond that already available from the private sector.

To successfully crowd-in private capital investment to UK infrastructure projects, the discussion paper is clear that the Bank is prepared to take on higher levels of risk than the private sector is able or willing to take on at present time. At the same time, the Bank has been established with a clear objective to make a commercial return on investment (in line with UKIB investment principle four). This is a delicate balance to strike as a purely commercial focus will send a message to the investor community that the Bank will likely crowd-out private sector involvement in UK infrastructure.

Over time, it should be possible for the Bank to make a commercial return whilst operating at the margins of the private sector's risk appetite. The Bank set-up team will need to handle the communications around this sensitively, as all stakeholders will need to be aware that with risk comes potential failure and the Bank should therefore build into its mandate some leeway in order to be future-proofed for this eventuality. The Canada Infrastructure Bank, for example, was established with a clear understanding and acceptance that a proportion of the Bank's investments might fail, with the Bank mandated to be able to lose up to CA$15bn over ten years.

What is clear is that the Bank will need to work carefully with private partners through each infrastructure sector to understand particular financing challenges and to determine the Bank's risk appetite for new technologies on a case-by-case basis. To do this, the Bank will need to develop innovative financing solutions, above and beyond that which is available currently from private sources to operate in an area of the market where the private sector would not ordinarily invest and therefore not crowd-out, while still seeking to make a viable commercial return.

Once the technology that the Bank has invested in has developed to a sufficient degree, the Bank should be consciously seeking to dispose of its stakes back into the market in order to be able to recycle its funds for future investment.

Risk and return

The discussion paper is also clear that to achieve this early-stage investment, the Bank will have to take on risk that the private sector cannot. This presupposes that its investments will have a higher risk profile (such as equity stakes in nascent technologies) but if the Bank is also to perform commercially, in line with the objectives set out in the policy statement, it will need to manage its risk exposure carefully. The Bank will therefore need to have a deep understanding of the risk profile of the investments it makes in order to invest where private markets cannot, whilst remaining within the bounds of a commercially viable investment mandate.

The Bank is also being positioned as a public-sector bank and not an infrastructure fund which implies that the Government sees a greater gap in debt rather than equity, but this is not a

feature readily observed in the UK market today where the funding gap lies mainly in early-stage development capital, with projects and technologies that are currently unable to attract long-term patient capital investment from infrastructure investors. GIIA's recent report with PwC 'unlocking capital for net zero infrastructure' describes in detail the challenges associated with investing in a range of infrastructure sectors and points to long-term policy solutions, including the role of the UK Infrastructure Bank in addressing these challenges[1].

In summary, there is a concern among GIIA investors that, depending on the priority of this objective over other objectives (i.e. in relation to climate change), the mandate of the Bank has been established in such a way that some form of 'crowding out' will be inevitable. It is an open question as to whether the Bank can identify an area of the market where private investors do not currently invest, due to development risks associated with emerging technologies for example, but where the Bank can play a role whilst still being able to achieve a commercial return.

Success measures

The discussion paper sets out a range of options under consideration as Key Performance Indicators, some of which we would suggest will be highly difficult to measure performance against. For example, it would be very difficult to empirically determine how the Bank's interventions in the market have increased sustainable and resilient infrastructure capacity across the economy, data for which would be difficult to draw a direct correlation from. GIIA would suggest that, instead, perhaps the most important measure of success is the rate at which the Bank can deploy capital and provide additionality in the market[2].

The Bank also has an important role to play as an interlocutor and conduit between the Government and the investor community, this way the Bank can help to focus minds across Government on long-termism in the planning of infrastructure programmes in the UK and in mitigating against the risk of short-term policy instability from short-lived political cycles with shifting policy priorities, by providing a form of 'political risk insurance' for investors.

In practice this would mean the Bank entering into long-term contracts with the private sector to fund infrastructure projects or support targeted sectors over an agreed time horizon. This could also help to provide greater clarity to investors regarding which sectors or technologies the Government will support for the long-term, as part of the strategy to achieve Net Zero by 2050, and therefore where private capital could play a role, thus crowding-in additional investment. This could also aid in the delivery of nature-based solutions which require a long-term approach to planning and delivery.

Sectors

GIIA agrees with the priority sectors as set out in the discussion paper. To complement these, we have set out a list of additional/complementary target sectors for Bank support which were

[1] GIIA and PwC, unlocking capital for net zero infrastructure (2020), URL
[2] The Canada Infrastructure Bank was widely criticized for failing to deploy capital, which was seen as a failure of that institution

developed through a series of workshops between GIIA investors with the Bank Chairman and former Financial Secretary to the Treasury in 2020-21:

- Long-term, subsidy-free renewable projects (i.e early-stage technologies in waste-to-sustainable-aviation-fuel);
- Early-stage hydrogen projects;
- Small modular nuclear reactors (SMR's);
- Merchant power offtake financing (including exploring how to enable further maturity in the corporate and public sector purchase power agreement (PPA) market);
- Offshore wind revenue stabilisers – enabling trajectory to 40 GW;
- Power grids to support Electric Vehicle charging;
- Battery technology;
- Carbon capture and storage technologies

To ensure that the Bank can deploy all of its capital, it should keep these sector definitions as broad as possible and ensure there is broad scope and opportunity to leverage the UKIB's funding when opportunities arise. It will be vitally important that within each of these sector definitions, the Bank remains focused on early-stage opportunities that involve nascent technologies where commercial models do not currently exist thereby reducing the risk of crowding out the private sector.[3] The Bank should also be seeking to exit investments in these technologies when they have achieved a suitable maturity to attract investment from private sources.

The discussion paper also appears to be quite heavily focussed on greenfield infrastructure projects (i.e. new infrastructure that is absent of the constraints imposed by prior development). As well as identifying new greenfield projects for investment, GIIA investors also see a role for the Bank in restructuring finance for existing brownfield projects which currently are unable to attract private investment.

Lessons can be learned in this regard from the role that the European Investment Bank formerly played UK brownfield projects by providing a product called 'project bond enhancement'[4]. This saw the EIB take a portion of the risk in projects that were not investment grade to help them attract private investment through a subordinated instrument—either a loan or contingent facility—to support senior project bonds issued by a private company for infrastructure projects[5].These types of innovative financing structures will be integral to ensuring that the Bank can crowd-in capital and also support much needed investment in brownfield as well as greenfield development.[6]

Lessons learned from international experience

The closest equivalent to the Bank today is the Canada Infrastructure Bank and, like the UK, Canada has a history of private sector involvement within a mature infrastructure market with

[3] Investment Monitor, What is the point of a UK infrastructure Bank, 2021 (URL)
[4] EIB, Project Bonds Guide, 2012 (URL)
[5] Ibid.
[6] Flint Global, Designing the UK infrastructure bank, 2021 (URL)

strong institutional investor presence. When it was established in 2017, the CIB had an ambition to spend CAD35bn but only managed to deploy CAD1.34bn in the first 3 years[7].

Unfortunately, for a number of reasons, including a perceived shortage of internal sector-knowledge and expertise, the CIB failed to leverage additional private sector investment into Canadian infrastructure projects and was deemed to have failed to deliver against its mandate within the first three years of its existence.

The key challenge for the CIB continues to be proving that a public infrastructure bank can crowd-in, rather than crowd-out, as well as the design of a test which can help in demonstrating a crowding-in effect. With an unsophisticated counterparty, it can be easy for a project proponent to change certain assumptions (discount rate, risk in construction costs) within an economic model to demonstrate that the returns do not justify solely private investment, thus requiring CIB or government support.

This highlights the importance of ensuring that the UK Infrastructure Bank can develop the right institutional knowledge of key infrastructure sectors, including an understanding of pricing trends and an ability to calibrate market measures such as setting an appropriate internal rate of return (IRR) for different types of projects, in order to demonstrate that the private sector would not ordinarily invest in a set project without Bank intervention.

Levelling Up

GIIA endorse the Bank's objective to support regional and local economic growth. Within this, investors see a role for the Bank as an advisor to local authorities in delivery of local infrastructure projects, helping to ensure that they understand the value that the private sector can bring in project delivery, management and expertise. As well as supporting regional and local economies to deliver the Government's goal of levelling up, the Bank must ensure that it provides financing solutions which connect environmental and social challenges to deliver an equitable transition to a low carbon economy.[8]

There is also potentially a risk of overlap between the Bank's net-zero and levelling-up objectives. Where an investment made by the Bank is primarily to support local and regional economic growth, the Bank will need to ensure that it does not do significant harm against the climate objective. In this way, Bank investments will need to be able to meet both objectives simultaneously.

UK Regulation

The Government made a strong statement of intent with the publication of the National Infrastructure Strategy 2020 which set out an overarching ambition to refine the UK's model of independent regulation to 'ensure it provides a clear and enduring framework for investors and businesses and delivers the major investment needed in decades to come'[9].

[7] Investment Monitor, What is the point of a UK infrastructure Bank, 2021 (URL)
[8] LSE, The new UK Infrastructure Bank can drive a just transition, 2021 (URL)
[9] UK National Infrastructure Strategy (2020), URL

Unfortunately, the experience of the delivery of economic regulation on the ground across core infrastructure sectors is directly undermining that positive intent. Regulation remains too heavily focused on short-term outcomes at the expense of long-term investment and has tended to be captured by short-term political interests which has created instability for investors just at the moment at which private investment is needed most.

Investors are encouraged by the latest signal of intent from the recently released Economic Regulation Policy Paper[10] particularly given that many of the areas on which GIIA have been engaging with BEIS and HM Treasury have been incorporated into the paper. We would highlight particularly the following areas: consistency of regulatory duties and standards across sectors; the need to prioritise intergenerational equity; a move to simplify regulators duties which have become overly complex and a review of the appeals process which aims for consistency whilst maintaining the merit-based approach.

Some of the sectors that the Bank has set out as priority sectors for investment in the discussion paper are covered by this economic regulation which is an area of considerable interest for private infrastructure investors and is currently subject to review by Government. The Bank may therefore wish to consider the contribution it can make in that debate, in helping Government and regulators to understand the importance of setting a regime that enables and incentivises long term investment and thus supports the Bank's objectives to crowd-in private capital.

Summary

The establishment of the UK Infrastructure Bank has been welcomed based upon assurances that its focus will be to 'crowd-in' and not 'crowd-out' the substantial amounts of private capital already available to invest in infrastructure.

To be successful at 'crowding-in capital' and addressing 'market failures' in a meaningful way, particularly in pursuit of ambitious net-zero carbon and social goals, the Bank will have to take on risk that the private sector cannot. Therefore, the Banks investments will carry higher risk and if the Bank is to perform commercially, it will need to manage that risk exposure carefully. The Bank will therefore need to have a deep understanding of the risk profile of the investments it makes in order to invest where private markets cannot, whilst remaining within the bounds of a commercially viable investment mandate.

The key measure of success is whether the Bank can deploy capital to projects that make sense to deliver new investment and provide additionality in the market. Therefore, the mandate for the Bank should be as broad as possible and flexible to mitigate against the risk that the Bank's capital fails to get deployed and present the broadest opportunity for private sector investors to leverage the Bank as new opportunities arise.

Contact details

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[10] BEIS, Economic Regulation Policy Paper (2022), URL