UK INFRASTRUCTURE BANK

DISCUSSION PAPER: POTENTIAL PRIVATE SECTOR OPPORTUNITIES IN PRIORITY SECTORS

20 JANUARY 2022

About the UK Infrastructure Bank

The UK Infrastructure Bank (the Bank) is a new, government-owned policy bank, focused on increasing infrastructure investment across the United Kingdom. Our core mission is to partner with the private sector and local government to increase infrastructure investment across the regions and nations of the United Kingdom.

We pursue this through two strategic objectives:

- to help tackle climate change, particularly meeting the government's net zero emissions target by 2050; and,

- to support regional and local economic growth through better connectivity, opportunities for new jobs and higher levels of productivity.

What we offer

We have two functions through which we will deploy our £22 billion of financing capacity – £12 billion for lending and investment and £10 billion of government guarantees.

Private sector: we offer a range of financing tools across the capital structure, including loans, mezzanine debt, guarantees and equity investments. The Bank has the financial capacity to make up to £8bn of private sector investment and deploy up to £10bn of government guarantees.

Public sector: of the £12 billion, £4 billion is earmarked for lending to local and mayoral authorities for strategic and high value projects of at least £5 million at a rate of gilts + 60bps. To complement this lending, we are developing an expert advisory service to help local authorities, and other project sponsors, develop and finance projects. This service will launch in due course and we will scale up its activity incrementally.

Our progress since launch

Since our launch in June 2021, we have engaged extensively with public and private stakeholders including local and mayoral authorities, public sector organisations, banks, investors, infrastructure advisers, project sponsors and potential borrowers. We are considering closely the National Infrastructure Commission's *Second Infrastructure Assessment Baseline Report* and the work of the Infrastructure and Projects Authority, have taken on operation of the UK Guarantee Scheme, and closed three deals. These conversations and experience have helped to further our understanding of where there is an undersupply of private finance in the UK infrastructure market and, in addition, how we can support high-value and complex local authority infrastructure projects.

In June 2022, we will publish our first Strategic Plan, which will set out our Strategy including our investment priorities. To support this strategy development over the coming months, this paper sets out emerging thinking on our private sector function, specifically where we can best deploy our £8 billion of private sector capital and £10 billion of government guarantees to crowd in and deliver on our two strategic objectives. This complements our ongoing engagement with the local government sector on deployment of the £4 billion of capital allocated to finance local authority infrastructure projects, and on the priorities for our advisory service.

This paper reflects what we have learnt from talking to stakeholders since our launch and our own expertise. It is not intended to represent a first draft of our investment strategy, rather it sets out our current understanding of the potential opportunities in our priority sectors. We are sharing this now because partnership is a core operating principle of the Bank. HM Treasury expect we will unlock more than £40 billion of overall investment. To achieve this, we need to work collaboratively with private and public sector institutions to finance infrastructure investment, leveraging their expertise and ingenuity to help us identify where and how we should deploy our resources. Also, just as crucial, we need to identify where we shouldn't invest to avoid displacing existing capital.

This is not a formal consultation document, but we are keen to know what others think. Over the coming weeks, we are conducting an extensive engagement exercise, talking to over 100 stakeholders to hear their views. If we are not talking to you and you would like to let us know what you think please email strategy@ukib.org.uk. Feedback received by 25 February 2022 would be particularly useful to help us further our strategic development in advance of publishing our first Strategic Plan.

Private sector function

To be eligible for funding, private sector projects must meet our four investment principles, as set out by HM Treasury in our Framework Document:

- The investment helps to support the Bank's objectives to drive regional and local economic growth or support tackling climate change.

- The investment is in infrastructure assets or networks, or in new infrastructure technology. The Bank will operate across a range of sectors, but will prioritise, in particular, clean energy, transport, digital, water and waste.

- The investment is intended to deliver a positive financial return, in line with the Bank's financial framework.

- The investment is expected to crowd in significant private capital over time.

Our dual objectives have huge potential synergies. Occasionally these objectives will be in tension with each other. Where an investment is primarily to support local and regional economic growth, we will ensure that it does not do significant harm against our climate objective.

Our activity is driven by the delivery of our two strategic objectives - tackling climate change and supporting regional and local economic growth. Our first Strategic Plan will set out how we intend to meet these objectives, and the Key Performance Indicators (KPIs) we will use to hold ourselves accountable for delivering against them.

We are considering potential KPIs which we could report against at an organisational and project level. For our climate change objective these could, for example, include relative carbon emissions in tCO_2e of our investment compared to the counterfactual; a measure of the increase in sustainable and resilient infrastructure capacity; or the alignment of our portfolio with the green taxonomy being developed by the UK government. For regional and local economic growth, they might include employment through the number of jobs supported; productivity through gross value-added measures; or a measure of impact on connectivity. These could apply equally to our private sector investments and local authority lending work. Given our focus on partnership and our investment principle to crowd in private capital we also expect to measure the private finance mobilised through our private investments.

The government's UK Infrastructure Bank Policy Design document in March 2021 set out that although the Bank's initial focus will be on climate change mitigation and resilience, the government will review the case for broadening this to include other areas such as improving the UK's natural capital. Our first Strategic Plan in June 2022 will reflect the outcomes of this review.

What distinguishes us from other lenders?

Our goal is to shape and accelerate the markets in which we invest. Infrastructure investment is vulnerable to market failure, as it is often complex, large, novel and long-term, with risks around construction, and technological or government policy changes. Our ambition is to help address these market failures and, in doing so, help direct private investment to projects that bring social benefits as well as financial returns.

We prioritise investments where there is an undersupply of private sector financing or where private sector financing doesn't reflect the full social benefits associated with an investment project. In doing so, we aim to crowd in private capital to deliver on our climate change and regional growth objectives. To achieve this, we need to act differently to other market actors – what distinguishes us is our approach to:

- **Risk:** we will consider taking more risk for the right deal and, where it is needed, we are willing to consider taking more risk than the market.

- **Flexibility:** we do not have a preferred investment type and can invest across the capital structure. Our investment team assesses each proposition on a case-by-case basis, working to identify the financing structure that fits the deal's needs most appropriately and supports the Bank's mandate.

- **Partnership:** as a government-backed policy bank, our presence in a deal can help instil confidence with potential investors. We will act as a cornerstone investor in challenging markets.

- **Leadership:** we want to provide practical and intellectual leadership across the most difficult challenges in these sectors, drawing on expertise in our networks and convening partners to accelerate market development and unlock private investment.

- **Concessional finance:** our approach to individual investments will be driven by the market failure we identify for that specific deal. Where the issue is simply one of market capacity, then we expect to invest on terms in line with other market participants. But we can go beyond that, where that is required to deliver our policy objectives. That might mean, as above, taking on risks that the market is unwilling, or not yet willing, to take in a way that encourages the development of new markets. In the right circumstances, it could also mean offering finance on terms more preferential to the borrower than would otherwise be available in the market, including on price and tenor, where that is justified to deliver against our policy objectives and compliant with our legal obligations.

Potential UKIB interventions

In delivering against our two objectives, we are open to consider investing in any project that meets our investment principles. We intend to be flexible in pursuing these objectives, adapting and responding to evolving market conditions to maximise our impact. Our investment mandate set by HM Treasury means we can invest across the infrastructure landscape, including in new infrastructure technology, and we have been asked to prioritise five sectors in particular. We assess investments on a case-by-case basis. Assessment against our investment principles is just one part of the Bank's decision-making process.

The following sections illustrate our current understanding of the financing gaps where the UK Infrastructure Bank has potential opportunities in our five priority sectors of clean energy, transport, digital, water and waste. This is not intended to be an exhaustive list and we will consider the right opportunities outside of these areas, but the below does indicate potential areas of focus that we might consider.

Clean energy

Clean energy captures many sectors and technologies, which are at varying stages of maturity.

In mature clean technologies that have strong access to finance – for example, offshore wind and solar – our consideration to date suggests that the Bank may add most value in:

- supporting the transition to subsidy-free business models for established technologies, as demonstrated by our investment in NextEnergy – a subsidy free solar developer.

- investments in aggregated projects that support the expansion of markets, such as for battery storage.

We do not otherwise see a strong case for the Bank making significant near-term investments in these mature technologies where finance is already available, except in so far as it may be required to build the Bank's capability and expertise to ensure we can support technological developments in areas such as floating offshore wind.

In general, we also do not think the electricity transmission and distribution network currently requires UK Infrastructure Bank support, as it has strong access to private, low-cost capital.

The government's *Net Zero Strategy* has ambitious targets to increase the deployment of mature clean technologies. We will therefore monitor the above markets and respond if, for example:

- there should be a role for the Bank to co-invest in senior debt instruments to fill any emerging financing capacity gaps in mature clean technologies.

Between £50-70bn of investment is needed to deliver 40GW of offshore wind by 2030[1].

- if developments in the electricity transmission and distribution network mean there could be a role for the Bank to co-invest in senior debt instruments to fill any emerging financing capacity gaps, in particular for Offshore Transmission Owners (OFTOs), where the scale of individual projects and acceleration of deal flow will increase significantly in the next few years.

Investing in UK supply chains can deliver on both our net zero and regional growth objectives. We think the Bank could, as we already have done with our first investment in Tees Valley, look to support and encourage the development of such supply chains, particularly in green technologies such as offshore wind and gigafactories.

The government's *Net Zero Strategy* highlights the role of increasing our nuclear capacity in the UK's plan to achieve its net zero ambition, and the stated aim is to secure a final investment decision on a large-scale nuclear plant by the end of this Parliament. In line with this, we see no in-principle reason why the Bank should not invest in nuclear and would expect to explore potential opportunities in the sector – for example, by the Bank helping to de-risk projects being procured under the Regulatory Asset Base (RAB) model.

23% of UK emissions come from heating buildings. Buildings are critical to the nation's net zero targets and hold many characteristics with other infrastructure sectors. Yet the finance available to deploy energy efficiency and heat technologies is generally retail or corporate finance. We are interested in exploring if we can finance innovative pilots or retail products that accelerate the deployment of energy efficiency and heat technologies.

Emerging net zero technologies – such as hydrogen, Carbon Capture Usage and Storage (CCUS) and greenhouse gas removals – are expected to play a critical role, particularly in the decarbonisation of industrial clusters. As things stand, we anticipate a significant pipeline in these technologies will not crystallise until the mid-2020s. But we are interested in identifying early opportunities to help accelerate the deployment of these technologies – for example, the CCUS clusters which should reach financial close within the next two years.

Transport

As the transport sector transitions to low and zero emissions models, we expect there to be opportunities for the UK Infrastructure Bank to play an enabling role to drive both our net zero and regional growth objectives. While public transport infrastructure is largely financed by the public sector, the Bank could play a role in numerous sub-sectors. This might include financing, for example, the procurement of

[1] https://auroraer.com/media/reaching-40gw-offshore-wind/; https://committees.parliament.uk/writtenevidence/5110/pdf/

greener rail rolling stock and zero emissions buses, supporting the government's ambition to remove all diesel-only trains by 2040 and for greener bus fleets that support local and regional connectivity.

The UK Infrastructure Bank's first local authority deal financed the creation of a quay to service the offshore wind sector. We think we should be open to private finance deals that support UK port infrastructure, particularly where it enables new clean energy infrastructure, e.g. in Offshore Wind/Floating Offshore Wind.

The plan for electrification of road vehicles and the phase out of internal combustion engines is well developed and will have a transformative impact on our transport infrastructure. Large amounts of government and private capital are needed here; but despite significant government support, there remains a challenge to unlock further private finance. We are therefore keen to explore what role the UK Infrastructure Bank could play in this transition, for example in co-financing electric vehicle charging infrastructure, or in supporting gigafactories and their supply chains.

Some other areas of transport are unlikely to be strategic priorities for the UK Infrastructure Bank private investment, either because they are publicly funded (such as roads) or not in line with our strategic objectives. Our role in aviation could be limited to sustainable aviation fuels infrastructure, as the technology and business models mature, or other investments that do no significant harm to our climate change objective.

Digital

As demonstrated by our recent investment in Gigaclear, we see a role for the Bank in financing gigabit capable broadband rollout in both rural and urban areas over the next few years. This is due to the significant financing demands in the sector which private supply may struggle to meet on its own. In doing so, we would be supporting digital connectivity across the UK, including the government's ambition to achieve 85% gigabit cable broadband rollout by 2025.

Considering the rapid evolution of this sector and the likely convergence between fixed and wireless technologies, the UK Infrastructure Bank will explore opportunities in the emerging delivery and business models. This could include supporting 5G rollout and technologies which do not currently exist at scale in UK markets.

We do not expect there to be a role for the Bank's financing products in supporting 4G, given existing government and private investment which will deliver coverage to 95% of the UK and the magnitude of subsidy likely to be required to go beyond that.

The National Infrastructure Commission is looking at the role digital can play in delivering smart technologies to underpin a range of infrastructure sectors. We will work closely with them as their thinking develops to understand whether there are financing gaps that the Bank might need to play a role in filling.

Water

We do not currently see a role for the UK Infrastructure Bank in investing in assets that fall within the RAB funding model, as we judge that UK water companies have strong access to private, low-cost capital.

There may be opportunities under the new Direct Procurement for Customers (DPC) model, and we will explore whether this is an area where the Bank can show leadership and help shape this new model.

Opportunities may emerge in catchment-level water quality and flood attenuation ecosystem services from 2024 onwards. The Department for Environment, Food and Rural Affairs (Defra) is currently working to establish business models and build a pipeline of investable natural capital projects. We will keep abreast of developments in this space.

Waste

We believe there may be a role for us in supporting the Energy from Waste (EfW) sector in its shift towards net zero by financing the deployment or retrofit of EfW plants that have a clear and deliverable plan on Carbon Capture, Usage and Storage (CCUS) and/or high levels of heat offtake.

More broadly, we are open to and would welcome enquiries on projects in recycling, sorting, advanced conversion technologies, sequestration opportunities and anaerobic digestion, including biomethane production. We are also interested in exploring how we can support infrastructure that enables the development of a circular economy, where this can be shown to deliver significant carbon savings.