

Interface

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CAN THE GREEN INVESTMENT BANK BREAK THE FUNDING LOGJAM?

With government cuts and austerity measures coming on top of an extended period of limited credit availability, businesses in the low carbon

sector have continued to face significant challenges in raising funds to realise their plans, whether for early stage innovative technologies or more mature, large-scale projects.

The proposals outlined for a Green Investment Bank could go some way to meeting these challenges, though as yet there has been much talk and little obvious action.

The Conservative Party established the Green Investment Bank Commission while in opposition as a key part of its manifesto commitments to sustainable development. Led by Bob Wigley (former chairman of Merrill Lynch in Europe) it published its report on 29 June 2010¹. The report is worth reading as an indicator of how the funding environment for green projects may develop under the new government, though it is far from clear how the recommendations will be implemented.

The challenge

The report identifies a massive challenge in raising funds for the development of the UK's low carbon infrastructure. An estimate of £550 billion is suggested over the next ten years but perhaps the best description of the scale is that development of this size has not been seen since reconstruction after the Second World War.

The report sees the key barriers as:

- **Market capacity** – there is at present insufficient private capacity to fund these requirements. Banks are still repairing their balance sheets, face further capital adequacy restrictions and low carbon investments are often seen by investors as risky.

- **Political and regulatory risk** – investors need to be able to make long term assumptions about the political and regulatory environment in the UK. Can we trust the politicians to stick to a consistent approach?
- **Confidence gap** – investors are uncertain about whether investments in the low carbon economy are a good bet. This is linked to the political risks but also reflects the challenges of picking winners in a wide range of early-stage technologies.
- **Aggregation challenge** – a key element will be delivering large numbers of small scale changes in homes and commercial buildings. How can that be packaged attractively for investors?

The Commission concludes that these challenges cannot be met by the market alone and that government intervention is required which could include:

- Investing alongside the private sector to add investment capacity.
- Reducing uncertainty by establishing a long term regulatory framework (though that is always vulnerable to the next government's latest idea unless some form of lasting cross-party consensus can be achieved).
- Offering guarantees or insurance to mitigate risk in much the same way the government has done to bail out the banks, and hopefully to greater effect.
- Providing new subsidies (or removing existing ones) to incentivise particular clean technologies, though this is somewhat down the list of the Commission's preferred techniques.

It proposes the response would be led by the Green Investment Bank.

What is a Green Investment Bank?

The Green Investment Bank would be established by Act of Parliament as an independent body tasked with supporting the delivery of this low carbon infrastructure.

The Commission envisages two elements: a venture capital arm of sorts - the UK Fund for Green Growth - focussing on growth businesses; and something more akin to an investment bank.

UK Fund for Green Growth

One key recommendation, perhaps seen as a quick win and attractive to the quango-cutting coalition government is to re-organise nine existing organisations and funds, which are

¹ *Unlocking investment to deliver Britain's low carbon future*, Report by the Green Investment Bank Commission 29 June 2010 <http://www.climatechange-capital.com/thinktank/ccc-think-tank/publications.aspx>

already organise nine existing organisations and funds, which are already providing public funding for low carbon innovation, into a "UK Fund for Green Growth" operating as part of the Green Investment Bank. Bodies to be brought within this umbrella would include the Carbon Trust, the Technology Strategy Board and the UK Innovation Investment Fund (itself only recently established by the last government). It is said that this will eliminate inefficiencies and duplication within these bodies and make it easier for businesses to access funding via a single point of contact.

It is fair to say that this proposal has already attracted criticism from the supporters of some of the legacy organisations, in particular the Carbon Trust, and the exact shape of their interaction with the GIB has yet to be settled. Despite that and the good work that bodies like the Carbon Trust have done, there is something to be said for this rationalisation. However, it certainly does not seem that this will produce any more funds for early stage technologies except through "efficiency savings" (which the Treasury will no doubt have its eye on itself). Indeed the Carbon Trust has already suffered a reduction in its budget of £12.6m and that may not be end of the pressures on these organisations.

Banking Division

The Banking Division would be more focussed on the larger scale projects and providing and enabling finance for those projects. It could offer a range of "products", including: debt and equity funding alongside private providers; risk reduction products such as guarantees or insurance which would reduce the cost of capital for private providers; and assisting in aggregating smaller projects into larger vehicles more suitable for institutional investors. The Commission seems to see this as the key role of the GIB.

Where will the money come from?

The report envisages the UK Fund for Green Growth being

funded by essentially taking over the budgets of the legacy organisations it would incorporate. The meatier challenge is in funding the banking arm of the GIB. The report places the decision on how to fund it squarely with the government but suggests funding could come from: sale of "green bonds" by the GIB to institutional investors; sale of government owned assets (e.g. the Tote, Dartford Crossing or the Eurostar link High Speed One), a proposal that already seems to have been disowned by the government; "Green ISAs" open to retail investors (the incentive being that future ISA allowance increases would be reserved for these green ISAs); and the auction of permits under the Emissions Trading Scheme (though there is scepticism as to whether these will raise as much as is hoped). These are not going to be easy questions to answer.

Is this the key to a low carbon future?

At present there has to be an open verdict on the Green Investment Bank. It certainly offers the hope (given the necessary political backing) of increased support for low carbon infrastructure projects. However, those involved in smaller and growing businesses, which should play a key role in developing next generation technologies, may legitimately feel that there is a distinct focus on large-scale proven engineering solutions rather than start-ups. There certainly seems to be no new money proposed for the UK Green Growth Fund.

And while the proposals are welcome, there is much to be done in putting the detail together. It is not clear how the government will respond to the Commission's report particularly in the light of the ongoing deficit reduction campaign. The Commission is very clear that if action is to be taken it needs to be taken quickly. An extended period of uncertainty about the government's intentions will simply add to the uncertainties facing investors and the difficulties for businesses in this sector. The recommendation is that the Green Investment Bank is up and running by the end of 2010.

The clock is ticking...

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