



HM Treasury

Infrastructure Finance Review: Summary of consultation feedback

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Chapter 1

Introduction

1.1 HM Treasury and the Infrastructure and Projects Authority (IPA) launched a public consultation on the Infrastructure Finance Review (IFR) in March 2019. The consultation closed on 5 June 2019 and the government received 117 responses. This document provides a summary of the responses.

1.2 Responses came from a range of sectors including financial services, not-for-profit, public sector, trade bodies, professional bodies, accounting firms, academia, utilities, construction, consultancy, legal and individuals.

1.3 This document does not set out individual proposals put forward by respondents, but instead highlights the key themes and points raised.

1.4 The government's full policy response is outlined in the National Infrastructure Strategy, published alongside this document. A summary is provided in Chapter 4.

1.5 The government also established an expert panel, drawn from industry and the public sector, to provide advice during the review process and input on the challenges facing the infrastructure finance market and how they can best be addressed.¹

1.6 The government would like to thank both the members of the expert panel and all consultation respondents for their time and valuable contributions.

¹ Members of the expert panel are listed here: <https://www.gov.uk/government/news/the-infrastructure-finance-review-expert-panel>

Chapter 2

The infrastructure finance market

Background

2.1 The consultation document set out:

- the role of private investment in infrastructure, and the key strengths and weaknesses of the UK market;
- future market challenges, including attracting finance to new, unproven technologies, large and complex projects, and ensuring a steady supply of finance during periods of adverse market conditions; and
- the role of the European Investment Bank (EIB) in the UK.

2.2 The consultation then asked the following questions:

- Do you agree with the strengths identified of the UK infrastructure finance market?
- What are the weaknesses in the UK infrastructure finance market?
- What is your assessment of the European Investment Bank's (EIB) role in addressing market failure? Where has the EIB provided additionality?
- To what extent can the private sector fill any gap in infrastructure finance left when the UK leaves the EIB?
- What new types of asset or technologies do you see coming to market in the next few years and what kind of financing issues might they raise?
- Does the market have capacity on a long-term basis to finance very large projects?
- What is your assessment of the vulnerability of infrastructure finance to a downturn in market conditions?

Summary of responses

Market strengths and weaknesses

2.3 Respondents broadly agreed with the strengths identified in the consultation document and that the UK has one of the strongest and most active infrastructure finance markets in the world. The UK's deeply liquid capital markets and world-leading financial services sector mean that there is finance available for most projects.

2.4 Respondents highlighted the ease of operating for international banks and investors and how the market has benefitted from London's position as a major financial centre. This in turn has enabled the UK to attract talented individuals and a range of investors, complemented by the technical expertise of professional services, engineering firms and public and private advisory bodies.

2.5 Respondents also noted the underlying strengths of the UK's legal and regulatory environment. Respondents highlighted that the strong, predictable and fair system, coupled with openness, transparency and strong corporate governance of the UK's institutions, has helped to build investor confidence.

2.6 Related to this, respondents highlighted the importance of government in providing stability and certainty for the market, setting strategic direction, and creating frameworks for investment. If government commitment to infrastructure varies over time, this can affect the construction pipeline and market confidence.

2.7 Respondents also identified some potential weaknesses. For example, political uncertainty was raised as a key risk, including the UK's future relationship with the EU and questions on future ownership in regulated sectors. Responses noted that public perceptions of private sector delivery have been negatively impacted by high profile Public Private Partnership (PPP) failures, a perception of excessive returns, and perceived impositions on local populations.

2.8 The impact of financial services regulations on certain sectors' ability to invest in infrastructure was also raised. Solvency II¹ was raised as a particular issue, with some respondents arguing that the strict capital requirements made it challenging for insurers to invest in certain types of infrastructure finance, such as infrastructure equity.

2.9 Several respondents commented on how risk had historically been allocated between the public and private sectors, and argued that in some cases, risks had not been transferred to those most able to bear them.

Future market challenges

New technologies

¹ Solvency II sets out regulatory requirements for insurance firms and groups, covering financial resources, governance and accountability, risk assessment and management, supervision, reporting and public disclosure.

2.10 In addition to the overall strengths and weaknesses outlined in the previous section, respondents commented on future challenges. Most respondents identified new technologies as a prominent financing challenge for the industry in the immediate and long term, recognising the rapid technological changes occurring in transport, energy and digital infrastructure, especially as the UK seeks to reach net zero emissions by 2050. A number of respondents also noted that there were new opportunities around the use of data to support infrastructure projects and innovative forms of financing.

2.11 Respondents noted that new technologies have different risk profiles to traditional infrastructure assets. One respondent identified that *"...a lack of track record, or market familiarity, combined with the large scale and long return on investment period typically associated with infrastructure, will naturally drive a financial risk premium that may limit the speed at which new solutions can be deployed, tested and proven."*

2.12 The risks identified by respondents include (a) technology risk and uncertainty over the best technology, which can lead to a lower investor appetite, a higher cost of financing and a delay in rollout, (b) cost uncertainty in both construction and operations and (c) demand risk and uncertainty around the commercial case for new products. The responses noted that as technologies develop and become proven, they become more attractive for investors – offshore wind generation is often cited as an example of this.

2.13 There was a consistent view that a gap exists in the availability of finance for new technologies, and that the current pool of infrastructure investors, in both debt and equity, have traditionally been focused on low risk or stable long-term return opportunities. Respondents felt that new technologies were "challenging the traditional characteristics of infrastructure assets" which in turn has created a gap between assets and investors.

2.14 Respondents identified numerous new technologies which will need financing in the coming years. These include electric vehicle charging, autonomous vehicles, energy infrastructure including carbon capture, utilisation and storage (CCUS), small modular nuclear reactors, and digital infrastructure such as fibre broadband and data centres.

Market capacity and vulnerability

2.15 Overall, respondents supported the view that sufficient liquidity currently exists in the market for large projects, with several citing examples such as Silvertown Tunnel and Thames Tideway Tunnel. Although, this can change over time, and there are differences in investment horizons between different finance providers, with banks having lower capacity for long-term investments than institutional investors such as pension funds.

2.16 One respondent said, *"The market has the capacity to cope with large projects (>£1 billion), but not necessarily at the same time."* Respondents noted that a reliable delivery pipeline and a smoothing of the infrastructure finance market could mitigate market capacity risks for large projects, enabling successful delivery over the longer term.

2.17 Responses varied on the vulnerability of infrastructure finance to a downturn in market conditions. Some respondents felt that the infrastructure finance market is

well-protected from the impact of financing market cycles – infrastructure tends to have long-term cash flows and stable demand. For example, one respondent identified that, *“long term infrastructure equity investors – such as pension funds or sovereign wealth funds – do not have exit deadlines and can therefore take a long-term view; they are not as exposed to economic cycles as open-ended funds or the public markets”*.

2.18 Some respondents noted risks from broader economic trends, regulatory risk, political risk, and the experience of the global financial crisis. During the crisis, reduced liquidity and market appetite led to the creation of government tools to support the market, such as the Treasury Infrastructure Finance Unit (TIFU). The government’s willingness to offer support helped the market to recover quickly, and many respondents supported the view that, in a downturn, the government has an important role to play as a lender of last resort.

Role of the European Investment Bank

2.19 A broad range of views were provided on the role of the EIB in UK infrastructure sectors. Respondents identified several benefits to the EIB’s presence in the UK, including competitive rates with flexible terms, and capacity to step in during economic downturns by offering additional liquidity. Consultation responses noted that the EIB provided additional liquidity during the global financial crisis, when there was insufficient private sector appetite to finance infrastructure projects.

2.20 The EIB’s independence from government and technical expertise were also identified as key benefits. For example, one respondent noted that *“The EIB’s position as separate from government removes the uncertainty in its role and behaviours across political cycles. It takes the long-term view.”*

2.21 Many respondents noted the EIB’s support for new technologies and greenfield investments, and its ability to act as a catalyst to bring in additional funding for higher risk projects. Respondents often cited offshore wind as an example where the EIB’s financing helped to facilitate capital flows into a new industry with limited history, and noted EIB’s contribution to Crossrail, Thames Tideway Tunnel and various rolling stock projects such as Thameslink.

2.22 There were mixed views on the EIB’s ‘additionality’ to the market. Broadly, respondents were of the view that given the significant supply of long-term debt finance in the market, the private sector would be able to fill some of the lending gap left by the EIB. However, the responses also noted that the private sector would find it difficult to fill certain gaps, for example on new technologies, and that a long-term UK replacement was required to target gaps in the market.

Chapter 3

Investment support tools and institutional framework

Background

3.1 The consultation document set out:

- the government's existing range of tools to support revenues in both consumer and taxpayer funded sectors and to support the supply of finance; and
- institutional options for delivering government support for infrastructure finance.

3.2 The consultation then asked the following questions:

- In the long-term, what lessons or models from established tools could be applied to different contexts?
- In what new ways could private finance be used to improve the delivery, management and performance of government-funded infrastructure projects?
- What is your view on the effectiveness of the existing government tools to support the supply of infrastructure finance?
- Should the government change, expand or reduce the levers it uses to support the supply of infrastructure finance?
- Should the government consider any alternative forms of finance support for sectors such as higher education or housing associations?
- Which sectors or types of infrastructure may need support from government to raise the finance they need, particularly in light of major technological changes?
- In your view, how effective is the current institutional framework at ensuring good projects can raise the finance they need?
- Is any reform to the UK's institutional framework needed to better provide support to the market?
- In the event that the UK loses access to the EIB, do you agree with the National Infrastructure Commission (NIC) that the government should establish a new, operationally independent, UK infrastructure

finance institution? If so, what should its mandate be, and how should its governance be structured?

Summary of responses

Investment models

Consumer funded infrastructure

3.3 Respondents were generally supportive of existing revenue support models. There was a strong consensus that there was no 'one size fits all', that no one model provided a 'silver bullet' and that the government should have a range of tools available.

3.4 The responses highlighted the wide range of models currently used to structure revenues and allocate risk, including the Regulated Asset Base (RAB) model, Contracts for Difference (CfDs), the Offshore Transmission Owner model, Direct Procurement for Customers in water, Cap and Floor for electricity interconnectors, and the Capacity Market in energy generation. Respondents noted the benefits of mechanisms that provide stable revenues and the ability to allocate risks to the parties best able to manage them.

3.5 The RAB model in particular was highlighted as a successful model for enabling investment and managing financing costs, while Contracts for Difference (CfDs) were seen to have been effective in attracting finance to renewable energy.

3.6 Respondents noted the flexibility of the RAB model and suggested that the government should build on the example of Thames Tideway Tunnel, which was described as "a poster child for how these projects should be managed". This would mean expanding the use of the RAB model to other sectors and types of asset.

3.7 For housing or universities, some respondents argued that policy should focus on addressing the underlying risks, such as long-term credit risk, rather than provision of finance. One respondent argued that alternative forms of finance are not needed for these sectors due to the private capital already invested.

3.8 Respondents also suggested additional points that the government could consider, including:

- Exploring new sources of funding for infrastructure, such as capturing land value uplift, crowd-funding and greater use of user-charging for roads;
- More clarity on how the private sector can engage with government on infrastructure and greater use of mechanisms which could bring forward market-led proposals. This could involve incentives to encourage the private sector engagement; and
- Improving capacity and expertise for Local Government to deliver larger infrastructure projects.

Taxpayer funded infrastructure

- 3.9 Respondents provided views on what new ways private finance could be used for government-funded infrastructure projects, following the announcement that the government will not be using PFI and PF2 for new projects and would not be seeking like-for-like replacement for these models.
- 3.10 Respondents were generally supportive of the government's rationale for not using PF2 for new projects, including 'fiscal illusion', long term fiscal risk to the taxpayer, inflexibility for public sector providers and operational complexity for public sector contract holders. Many respondents agreed that infrastructure contracts should not be designed to achieve a particular balance sheet treatment as this could lead to poor value for money when designing contracts and making decisions. One respondent noted that: *"obligations to make payments throughout the 20-30-year term of a concession is [sic] de facto national debt."*
- 3.11 However, some respondents also suggested that new 'off-balance sheet private finance' models would be needed to "fill the gap" created by the retirement of PF2 and given wider fiscal constraints on the level of government spending.
- 3.12 Respondents also engaged in a debate about the value of private finance in improving the delivery of government-funded projects. Many argued that private finance could incentivise delivery on time and to budget, by creating "skin in the game". However, others suggested these benefits could be achieved without private finance – for example, by undertaking long-term bundled contracting for the design, construction and operation of an asset.
- 3.13 Respondents also commented on the right levels of risk transfer in an infrastructure contract. Although respondents recognised that risk transfer could incentivise better delivery, many respondents argued that government transferred too much risk, driven by lowest cost procurement. One respondent summarised this as: "3% margin businesses cannot take 50% risks". Some in the finance industry felt government could do more to de-risk investments, where it was best placed to manage specific risks.
- 3.14 Finally, respondents proposed some alternative ways that private finance could be used for government-funded infrastructure. Most of these built on the retired PFI model (for example by changing the financing structure or amending contracts in other ways). Other respondents suggested that government could use revenue models from consumer-funded infrastructure sectors (such as the Regulated Asset Base from water and energy) for government-funded infrastructure.

Financing support tools

- 3.15 Respondents noted that the government has a strong set of existing tools and should continue to maintain these. In light of the future challenges,

many responses suggested reform of existing tools, and the creation of new tools. For new technologies in particular, respondents identified that government would require more risk-bearing tools to proactively respond to project risks.

- 3.16 Several respondents stated that the UK Guarantees Scheme (UKGS) is a useful tool which provides the market with confidence and only intervenes where necessary. The responses suggested that the UKGS could be made more flexible – for example by targeting specific risks in projects, or by extending the scope beyond ‘nationally significant’. Some respondents supported the creation of credit enhancement tools to target specific risks, such as complex construction risk, revenue ramp-up risk or counterparty credit risk.
- 3.17 The Digital Infrastructure Investment Fund (DIIF) and Charging Infrastructure Investment Fund (CIIF) were also mentioned by many respondents. There was support for the creation of new co-investment funds where government acts as a cornerstone investor, and respondents were supportive of tools that address market failures and gaps, take targeted risks to improve risk profiles, and target new and developing markets. One respondent identified that tools should “...ensure scope for private sector commercial innovation which can drive accelerated development.”
- 3.18 Responses discussed whether requirements to act commercially and co-invest with private capital may hold these funds back from accelerating the development of new technology, and some respondents argued sector-specific funds are more difficult to manage than broad, technology-neutral funds.

Institutional framework

- 3.19 Consultation responses were broadly positive about the UK’s existing institutional framework. They highlighted the IPA’s expertise and recognised the important role it plays, including through its delivery of funding initiatives for new technology, such as the DIIF and CIIF. Some respondents thought that this is sufficient, and new tools could be administered by the IPA if necessary.
- 3.20 Many respondents, however, recommended reform to help meet market needs and future challenges, citing institutions such as the EIB, the European Bank for Reconstruction and Development (EBRD) and the KfW (Germany), as examples of successful financing institutions.
- 3.21 There was support for a new, enduring body to deliver infrastructure finance support tools, in line with the NIC’s recommendation. Respondents noted that this body would need to operate independently within a clear mandate from government, have a flexible toolkit, and the ability to increase activity when required by the market.
- 3.22 Consultation respondents suggested that the mandate for any new institution could focus on innovation, reaching net zero, and supporting the government’s infrastructure strategy. Respondents were clear that a government institution should seek to crowd-in, rather than crowd-out,

private investment, be agile and adaptable to market conditions and to consider regional balance.

- 3.23 Operational independence was viewed positively by respondents, who noted that it increases efficiency and ensures commercial decision making. However, there were a range of views on the best structure and respondents said that finance support needs to operate in line with the government's overall infrastructure goals. One respondent argued that "there is no perfect answer – the benefits of 'operational independence' can be outweighed by too great a detachment from political sponsorship and support".
- 3.24 Consultation respondents also noted that infrastructure finance support needs to work effectively with other government infrastructure bodies such as the NIC, and other parts of the public sector such as local government, the British Business Bank and Homes England.
- 3.25 Finally, respondents noted the importance of building expertise within an institution. They argued that this would then allow it to act as a source of expertise on financial tools, commercial models and infrastructure technologies. One respondent suggested that *"A single infrastructure 'hub' is important particularly for small and medium sized businesses and those in smaller local authorities or higher education institutions who do not have the volume of infrastructure works to develop their own expertise"*.

Chapter 4

Policy response and next steps

4.1 The private sector plays a vital role in achieving UK's infrastructure ambitions. The UK needs a system that supports transformative investment, while also delivering policy goals around levelling up, decarbonisation and high-quality consumer outcomes. The government's overall approach to supporting private investment in infrastructure is set out in the National Infrastructure Strategy. This approach is informed by the responses to this consultation, and is focused on three main areas, a new national infrastructure bank, improving independent economic regulation and continuing to develop innovative tools to support investment.

4.2 The government will establish a major new national infrastructure bank to co-invest alongside the private sector in infrastructure projects. This will replace some of the activities of the European Investment Bank (EIB), and will provide more targeted support than the EIB, to be better aligned with the UK government's objectives. In line with recommendations of the NIC and the feedback received through this consultation, the new bank will operate within a mandate set by government, have a high degree of operational independence and will be a world-class, expert institution.

4.3 The government recognises the vital role played by the UK's system of independent economic regulation in attracting private investment. The government is committed to the model of independent economic regulation and will refine it to ensure it delivers the major investment needed in decades to come, while continuing to deliver fair outcomes for customers. The government has taken on feedback from this consultation and recommendations made by the NIC in their report *Strategic Investment and Public Confidence*. The government will produce an overarching policy paper on economic regulation in 2021, which will consider regulator duties, injecting more competition into strategic investments, and the benefits of a cross-sectoral Strategic Policy Statement.

4.4 The government has already developed a range of tools to attract investment and will continue to apply these in new areas and develop further innovative models to meet specific challenges. The government will not reintroduce the Private Finance Initiative model (PFI or PF2).

4.5 The government's full policy response is outlined in the National Infrastructure Strategy, published alongside this document. The government is grateful to all stakeholders for their engagement to date and remains open to new ideas and feedback.

HM Treasury contacts

This document can be downloaded from www.gov.uk

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