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Strategic steer to the UK Infrastructure Bank

Dear John,

Recent events mean that I'm writing to you in an uncertain and challenging domestic and international economic context. Nonetheless, I would like to congratulate you and the team in the Bank for the progress made in establishing this exciting new institution, and for the collaborative working between you and your colleagues and officials in HM Treasury and throughout government. I am pleased to have seen the Bank make its first investments into subsidy-free solar, wind turbine manufacturing capacity, ultrafast broadband and a new green bus route. It was also good to see your early views on investment opportunities across your priority sectors in your recently published discussion paper.

The role the Bank can play in reducing the UK's dependency on fossil fuels and increasing prosperity across the country has been brought into sharp focus by Russia's unprovoked invasion of Ukraine. In particular, it is important that we take every step possible to improve our energy resilience, to protect us from future shocks and volatility in global markets. This does not change the long-term mission of the Bank but emphasises the need to make rapid progress on its net zero goals, particularly where they overlap with the government's renewed focus on energy security.

With this context in mind, this steer is intended to provide further detail on the government's priorities for the institution and to help you to interpret the policy mandate as you develop the Bank's first strategic plan. It incorporates the outcome of the government's review of UKIB's environmental objectives, which can be found in full at Annex A.

As you will be aware, the government is planning on including a 'Strategic Steer' provision in the Bill that will place the Bank on a statutory footing, for government to articulate its priorities formally to the Bank. This steer is not statutory but please treat it as reflective of the government's position for this parliament.

Prioritisation and definition of infrastructure

In the UKIB Policy Design document, the government outlined that the Bank's primary focus should be on economic infrastructure. The Framework Document outlined that it should prioritise in particular clean energy, transport, digital, water and waste. In light of the recent circumstances, I'd encourage you to prioritise opportunities that align with the government's renewed focus on energy security. Examples of relevant opportunities may include helping to bring forward low carbon energy projects that accelerate the UK's transition to clean energy and improve the energy efficiency of buildings and homes.

As you know, the government plans to set out a definition of infrastructure as part of the legislation to put the Bank on a statutory footing. In doing so, we are mindful of retaining the flexibility we have provided so far for the Bank to consider projects across different sectors. The government is supportive of the approach to potential UKIB interventions set out in your recent discussion paper including your interpretation of clean energy, which clarifies that nuclear is in scope, noting that you will need to update this to reflect your industry engagement and the contents of this steer. To limit ambiguity, we want to provide further detail on which areas should fall within scope for the Bank.

The Bank should not ordinarily support projects which are predominantly social or cultural infrastructure. This includes housing, schools, health facilities, courts, prison facilities, sports venues or cultural venues (theatres, libraries, museums, cinemas etc.). This does not prevent the Bank from considering mixed infrastructure projects, such as a town centre regeneration, where there is a significant economic infrastructure component, alongside other sectors that in isolation would not normally be supported.

Although the construction of new housing should not be considered by the Bank (besides the circumstances set out above), projects or technologies that support energy efficiency, including the retrofit of existing homes and buildings, and/or the decarbonisation of heating, in line with the government's Heat and Buildings Strategy, are in scope. This reflects the strategic importance of the net zero transition, as well as the urgent need to improve the energy efficiency of our buildings in the context of high energy prices and the government's renewed focus on energy security.

In addition, projects involving Greenhouse Gas Removals (GGRs), which will play an important role in the transition to net zero, should be treated as within UKIB's scope. This includes both engineering-based approaches (such as Direct Air Carbon Capture and Storage) and nature-based approaches (such as afforestation and soil carbon sequestration), as detailed in the Net Zero Strategy.

Interpretation of strategic objectives

Tackling climate change

The challenge posed by climate change remains clear and our response to it is more important than ever. The finance provided by the UK Infrastructure Bank can play a significant role in bringing through new technologies and scaling up existing technologies that help to mitigate this threat by reducing the UK's emissions. The Bank should work closely with central government to ensure its activities are complementary to the government's Net Zero strategy, climate and energy security goals. Clean energy is one of UKIB's priority sectors and projects that both help us transition to net zero and reduce our reliance on fossil fuels should be particularly prioritised, as far as they can help you achieve your existing objectives.

As part of its climate objective, it is also important that UKIB explores projects that make the UK's infrastructure more resilient to climate change and better adapted to future risks. More broadly, climate risk - including the impact of climate change on financial assets - should help to inform the Bank's decision making. Accordingly, I would expect the Bank to align with the UK's reporting requirements for green finance as these evolve and come into force over time. Such requirements currently include disclosures aligned with the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD). In time, such requirements will evolve into the UK Sustainability Disclosure Requirements (SDR) which will include reporting against the UK Green Taxonomy. UKIB should help the greening of the UK's financial services sector, through its approach to climate risk and sustainability standards.

Supporting economic growth, including at a regional or local level

Addressing the deep spatial disparities across and within UK regions is a central ambition of this government. Economic infrastructure connects people, both physically and digitally, to opportunities and the Bank has a key role to play in providing infrastructure finance across the UK and targeting investment to support faster growth in regions with lower levels of productivity. Increasing prosperity across the UK is a core component of our economic security.

The Bank's Framework Document explained this objective as supporting growth 'through better connectedness, opportunities for new jobs, and high levels of productivity'.¹ The government's recently published Levelling Up White Paper (LUWP) outlines the need to end the geographical inequality which is such a striking feature of the UK and it is important that UKIB supports this ambition. Therefore, I would encourage the Bank to target its portfolio of investments towards projects across the UK that deliver against the missions set out in the LUWP, and in particular, missions 1, 3 and 4 – relating to

¹ UK Infrastructure Bank framework document, 17 June 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994437/UK_Infrastructure_Bank_Framework_Document.pdf

employment and productivity, transport infrastructure and digital connectivity – which most directly align with the Bank’s remit.² To maximise the impact of its investments in supporting economic growth, UKIB should consider how it can invest alongside other place-based interventions by both private and public sectors.

Local authority lending and advisory function

There is an exciting opportunity for the Bank to utilise its £4 billion of local authority (LA) lending capacity to develop high value and strategic projects, across the UK, that meet the UKIB’s strategic objectives. I look forward to seeing your plans to develop the LA lending offer as the Bank moves into a steady state. More broadly, the UKIB’s LA lending offer will exist alongside the Public Works Loans Board (PWLB) which provides lending to LAs for a broad variety of capital spending. In order to maintain a consistent approach to LA lending policy across government, we would like the UKIB to align its approach to assessing LA credit risk (i.e. the risk of non-repayment) with that of the PWLB and to maintain alignment as PWLB policy evolves. Beyond this, as an operationally independent organisation with its own investment principles and mandate, the UKIB should form a judgement on other risks and the merits of specific investment proposals and use its discretion to decide whether or not to invest in an LA project.

I also look forward to seeing your plans for UKIB’s advisory function in the strategic plan. This function will be increasingly important for achieving your policy goals and empowering local authorities to deliver infrastructure projects that bring economic benefits across the country.

Devolved nations

As set out in the Policy Design document, the Bank should work constructively with government and institutions in each nation of the UK to maximise the impact of its investments and to develop a nuanced understanding of the characteristics of the market in each nation so that it can target its investments appropriately. This will include prioritising the building of strong relationships with the Scottish National Investment Bank and the Development Bank of Wales and working closely with the Northern Ireland Executive in ways that are compatible with the UK’s devolution arrangements. Over time, I’d expect UKIB to focus its investment and engagement towards building its presence in the market in all four nations. I would encourage you to monitor the impact that the Bank is having in each nation accordingly.

Outcomes of the Environmental Review

As part of the government’s review of the Bank’s environmental objectives that was announced in the UKIB Policy Design Document, we have heard from stakeholders across different sectors who were positive about the role the Bank could play in supporting

² Missions 1, 3 and 4 are set out in the Levelling Up White Paper, <https://www.gov.uk/government/news/government-unveils-levelling-up-plan-that-will-transform-uk>

nature-based solutions and private markets for ecosystem services³. A full report of the review findings can be found at Annex A.

The government believes there is a potential role for UKIB, alongside other institutions and DEFRA, to play in these markets because:

- There is significant scope for nature-based solutions to contribute to UKIB's current objectives – climate change and regional and local economic growth.
- UKIB has a mandate, set out in the Policy Design and Framework documents, to act as a cornerstone investor, leveraging in private capital to address financing gaps in new or novel markets.

I therefore would encourage the Bank to consider the role it could play in nature-based solutions and how that might develop over time. Any projects in which the Bank invests must of course be in line with your investment principles, including the investment being intended to deliver a positive financial return in line with the Bank's financial framework and crowding in private investment. I would expect the Bank to make the same considerations for nature-based solutions as for other investments.

The Bank can also have a positive impact on natural capital beyond direct investment by including nature in its decision making. I'd therefore encourage you to consider options for embedding environmental impacts into the project appraisal, monitoring and reporting processes.

Additionality

As set out previously, I hope to see your strategic plan reflect a focus on maximising policy impact through your interventions, using public policy expertise and banking rigour to overcome barriers to finance in the market.

Additionality can be achieved in different ways and the institution should consider how its financial offering can be complemented by the technical expertise that it can provide to support project development, particularly when the Bank's resource and capacity has been scaled up.

I would expect the Bank to be proactive in supporting new sectors and developing innovative financing structures to fulfil its market making role.

Partnerships and convening role

UKIB's ambitious mandate and balance-sheet give it significant potential to drive positive change in the infrastructure market across the UK. It benefits from its position spanning public and private sectors which it should leverage to share knowledge and insight and to make connections to support market development. I'd expect the Bank to form strong relationships with all levels of government, including mayoral and local authorities and

³ The services such as water quality and regulation, carbon capture, biodiversity, air quality, noise / visual impact abatement, and recreation that a functioning ecosystem may provide.

the devolved governments. It should also work closely with relevant public bodies across the UK. I am also pleased to see that you are already engaging and forming strong ties with investors and project developers.

Management of the UK Guarantee Scheme (UKGS)

As well as developing UKIB's own guarantee scheme to deliver £10 billion in guarantees capacity to help deliver the Bank's objectives, the Bank is also responsible for administering and managing existing guarantees issued under the UK Guarantees Scheme (UKGS) that was previously the responsibility of the Infrastructure and Projects Authority. The continued effective management of the UKGS is a priority for HMT and therefore should be an important priority for UKIB. I would like to thank you and your colleagues for supporting HM Treasury to manage the existing portfolio. My officials will work closely with the Bank to set out a framework that empowers the Bank to use its capability and expertise to effectively manage the UKGS legacy guarantees on behalf of HM Treasury.

I look forward to seeing the strategic plan develop and I'd be grateful if the issues raised in this letter could be incorporated into your thinking.

Best wishes,



RISHI SUNAK

Annex to strategic steer – Outcomes from the Government’s review of UKIB’s environmental objectives

Overview

As committed to alongside Spring Budget 2021, the government has reviewed the case for broadening the UK Infrastructure Bank’s environmental objectives to include other areas such as improving the UK’s natural capital.⁴ It has examined the markets for nature-based solutions and ecosystems services to explore whether there could be benefits from UKIB intervention,⁵ and considered whether any policy changes are required as a result.

As part of the review, officials have held discussions with a range of stakeholders with relevant experience in the sector, including environmental advisory groups, financial institutions, local authorities and investors.

UKIB’s policy objectives

The Bank’s existing objectives are to:

- 1) **help tackle climate change**, particularly meeting the government’s net zero emissions target by 2050; and
- 2) **support regional and local economic growth** through better connectedness, opportunities for new jobs and higher levels of productivity.

In pursuit of these objectives, the Bank will look to provide support to novel markets and bring in private capital to areas that are currently under-financed.

The Bank’s climate objective allows it to consider investment opportunities that help to mitigate climate change and reduce emissions, but also projects that help the UK’s infrastructure to adapt and become more resilient to its effects.

The market for nature-based solutions

Protecting and enhancing the natural environment, and the biodiversity that underpins it, is crucial to supporting sustainable, resilient economies, livelihoods and well-being. The government is determined to support the development of private markets that drive investment in projects that restore or enhance our natural environment. This is demonstrated by the commitment made at the 2021 Spending Review to target at least £500m of private investment in nature every year by 2027 and more than £1 billion a year by 2030.

⁴ Natural capital refers to the stock of natural assets that society and the economy depend upon, including the atmosphere, forests, fisheries, rivers, biodiversity, land and minerals, and both the living and non-living aspects of ecosystems.

⁵ Nature-based solutions refer specifically to protecting, restoring, and managing the natural environment in ways that contribute to addressing socioeconomic challenges such as: climate change; flooding and coastal erosion; making cities more liveable; protecting food and water supplies; and improving water quality.

The market for revenue-generating natural capital projects in the UK has significant growth potential but is presently relatively small, with few transactions being completed and a small pool of market participants, limited to those with specific sector expertise. Revenue streams for projects are largely driven by payments for ecosystem services⁶ such as carbon offsets, biodiversity offsets and water quality.

Stakeholders highlighted that most UK projects are small-scale (below £1 million). However, the Dasgupta report on the Economics of Biodiversity noted that the mean average value of nature-related projects in Europe has been around €7.4 million. The European Investment Bank's Natural Capital Financing Facility has supported 7 projects (from 2017 to 2021) with an average loan size of €7m and the majority between €5m and €6m. While it is difficult to compare data given inconsistencies in classification of nature-based projects, the evidence available suggests individual projects are currently concentrated at the lower end of the market in terms of scale.

Private sector involvement is expected to grow

Private sector involvement in the market will need to scale up significantly to bridge the financing gap for nature-based outcomes in line with government policy, which the Green Finance Institute estimates to be £56 billion over the next ten years.⁷ The evidence suggests that most commercial lenders are waiting for the market to develop further before actively participating at significant scale. Globally, a similar picture emerges – a UN Environment Programme report in 2021 found that in 2020 approximately 86% of global investment in nature-based solutions was publicly financed, with only 14% privately financed.⁸

However, stakeholders have outlined that there is growing private sector interest in the sector and investors are increasingly considering opportunities in the market. For example, in 2020 HSBC and Pollination Group launched a natural capital fund, 'Climate Asset Management', to invest in a diverse range of projects that will preserve, protect and enhance nature over the long-term. It is the first large-scale venture to mainstream natural capital as an asset class. Santander are an early supporter of Revere, a partnership between Palladium and the UK National Parks to design and privately fund nature restoration projects.

The voluntary carbon credit market in the UK has seen a significant increase in demand with firms increasingly looking for domestic opportunities to offset their carbon

⁶ Ecosystem services are the services such as water quality and regulation, carbon capture, biodiversity, air quality, noise / visual impact abatement, and recreation that a functioning ecosystem may provide.

⁷ Green Finance Institute, The Finance Gap for UK Nature, October 2021 -

<https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2021/10/The-Finance-Gap-for-UK-Nature-13102021.pdf>

⁸ UN Environment Programme, State of Finance for Nature, May 2021 -

<https://www.unep.org/resources/state-finance-nature>

emissions. However, the market is presently constrained by the availability of carbon-abatement projects to match the demand for credits.

There are several challenges to achieve greater levels of investment

Currently, the market for nature-based solutions is restrained by several barriers to finance that need to be addressed for a mature commercial market to develop. These include insufficient scale or aggregation of smaller projects, lack of proven revenue streams, lack of data and universal standards, novelty risk and limited demonstration. To tackle these barriers will require a mix of policy levers from government, as well as financing support across the public and private sectors.

The government has plans in motion to develop and improve standards and accreditation for ecosystem services. A developed standard already exists for woodland carbon credits which are traded on the voluntary market. A further suite of standards is being developed including for peatland, biodiversity, soils, water quality, and flood risk mitigation. These codes underpinning the market will increase private sector confidence in transactions and create more revenue opportunities for landowners.

In addition, DEFRA launched the £10m Natural Environment Investment Readiness Fund in February 2021, providing grants to help organisations develop a pipeline of revenue-generating natural capital projects, suitable for private investment. DEFRA is also initiating the Big Nature Impact Fund, a blended finance vehicle, which will be managed by a private sector fund manager, designed to use public concessionary capital to attract private capital into the Fund. The Fund will invest in a portfolio of natural capital projects that can generate revenue from ecosystem services to provide a return on investment. These initiatives will support the growth and commercialisation of the natural capital market, addressing each of the barriers identified above.

The role of UKIB

Some stakeholders have advocated that the UK Infrastructure Bank could add further impetus to this market, using its financing toolkit, expertise and relationship with central government to provide leadership and encourage co-investment. Concessional finance can help projects get off the ground and patient capital can provide the long-term security to match the requirements of nature-based projects.

Most stakeholders observed that there is significant scope for intervention in nature-based solutions within UKIB's existing mandate, particularly through its climate mitigation and adaptation objective and scope to invest in flood defences, water and wastewater infrastructure. For example, projects such as peatland restoration and afforestation could have a significant positive impact on carbon abatement and flood risk management, in line with the Bank's policy objectives for climate change mitigation and adaptation. Nature-based projects are likely to be increasingly common as biodiversity net gain is mandated for most developments and sectors such as the water industry are challenged

to make greater use of nature-based solutions and hybrid grey-green infrastructure to meet their environmental responsibilities wherever appropriate.

Conclusion

The challenges and opportunities in the market for nature-based solutions and ecosystems services are clear and were observed consistently by stakeholders. There was also general agreement that a public financing institution could help to unlock the market and bring in private investment.

UKIB has a mandate to act as a cornerstone investor, leveraging private finance into underdeveloped markets to achieve policy outcomes. Natural capital is an important contributor to climate adaptation and mitigation, in line with the government's net zero strategy.

Given the overlap between UKIB's mission and the policy challenges in the natural capital market, the government believes there is an important role for the Bank, working alongside other institutions, to support this agenda over time.

Nonetheless, the Bank will need to consider its activity in this area in the same way as in relation to other parts of its portfolio. For private investments this means following the investment principles, which include the need to provide a financial return and to crowd in significant private capital over time.

Based on the findings of this review, we believe that support for nature-based solutions can be delivered through the Bank's existing policy framework, without the addition of a specific third objective on nature. This will enable the Bank to focus on building its capability to meet its two stretching objectives on tackling climate change and supporting regional and local economic growth.

This strategic steer encourages the UK Infrastructure Bank to explore early opportunities in nature-based solutions, and over time the Bank should aim to have a positive impact on the development of the market.

In addition, to ensure that nature is incorporated in the institution's decision making, UKIB should embed environmental impacts into its project appraisal, monitoring and reporting processes.