opportunity south essex

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Infrastructure Finance Review
HM Treasury (2 Orange)
1 Horse Guards Road
London
SW1A 2HQ

22nd May 2019

Dear Sir/Madam

Infrastructure Finance Review Consultation

Opportunity South Essex (OSE) is a private-public partnership whose vision is for South Essex to have one of the fastest growing and most sustainable economies in the UK, providing opportunities for businesses, attractive for inward investors and benefits local communities.

This letter forms our response to the Infrastructure Finance Review Consultation and we have structured this response around the 16 consultation questions.

1 Do you agree with strengths identified of the UK infrastructure finance market?

Broadly yes. We should recognise that there is already significant private sector investment and ownerships – for example all significant port groupings (with the exception of Dover) are in private ownership as are a number of our utility companies, many of them having overseas owners. This demonstrates that the UK is very attractive to overseas investors.

2 What are the weaknesses in the infrastructure finance market?

There is a weakness where projects are not reaching the rates of return expected by private investors and developers. These projects are likely to be worthwhile and would provide a range of benefits, which may not be financial, but would not proceed because they don't clear the hurdle rate for investment. There is a need to consider how viability of the project can be supported in a way that does not provide an indirect subsidy to prop up a rate of return. Public finance can potentially accommodate a lower rate of return.

3 What is your assessment of the European Investment Bank's role in addressing market failure? Where has the EIB provided additionality?

The EIB has clearly provided significant support to many large projects in the UK. This has supported a range of major projects, housing associations and support for businesses to grow. It has also provided seed funding and credit lines for regional investment funds which have gone on to support a range of projects. It is quite likely that the projects supported may not have been able to access other forms of borrowing. In short, we need an alternative route to lower cost borrowing to support major transformative projects where commercial borrowing would adversely affect financial viability.

However, it is not clear whether the EIB has directly addressed market failure. It is an alternative source of finance when commercial lending may be unobtainable or more expensive but the EIB may place further conditions within their financial agreements with projects.

4 To what extent can the private sector fill any gap in infrastructure finance left when the UK leaves the EIB?

There is significant potential for the private sector to infrastructure in the UK, particularly from overseas investors. Based on the EIB's own figures, they have invested 108bn Euro, across over 1,000 projects since 1973. This equates to roughly 2.35bn Euro per year (circa £2bn). This must be set against the level of investment that the UK Government has made (£18bn). Projects such as Crossrail and Thames Tideway Tunnel have been supported by the EIB.

The EIB has invested based on its policies which consider socio-economic benefits. The private sector would be more focused on the rate of return. Therefore, the private sector may find it difficult to invest because the socio-economic returns may not be possible to monetise. Some private sector investors may be willing to consider returns against their corporate social responsibility policies (especially where the aims of CSR correlate with the socio economic benefits), but this can't be relied upon.

The UK may still have access to the EIB after it leaves. The EIB have made investments outside of the EU, but these have been on a more commercial footing than investments made within the EU. Therefore, the socio economic returns may feature less in any lending decision.

5 What new types of assets or technologies do you see coming to market in the next few years and what kind of financing issues might they raise?

Digital infrastructure and the use of data present a significant area of opportunity. This will also present a range of opportunities for innovative financing which may see creation of new asset bases.

New technologies and assets will provide a platform from which you can grow the economy. This would create both commercial and socio-economic returns on investment, creating a climate for co-investment by both public and private sector. However, we should be mindful that this co-investment is not constructed in a way to directly support commercial return.

6 Does the market have capacity on a long-term basis to finance very large projects?

The market may have the theoretical capacity, but it would be wholly dependent on investors securing an attractive rate of return. Some projects may drive lower returns or demand longer repayment terms which may be outside the usual commercial expectations.

7 What is your assessment of the vulnerability of infrastructure finance to a downturn in market conditions?

Infrastructure finance is always vulnerable to a downturn in market conditions – evidenced by the years following the credit crunch. In recent years, the public sector borrowing rates have been very low which could have been a real opportunity to support the economy by borrowing to support investment in infrastructure. There would be a direct benefit in jobs created, and also having the infrastructure in place to capitalise when growth returns.

However, investment in infrastructure is very long term which can be extended due to the planning processes to secure consent to proceed. This will need a clear commitment to run through this process.

8 In the long-term, what lessons or models from established tools could be applied to different contexts?

We need to understand what drives private sector interest in investing. This would be driven by a rate of return and a clear plan of exit at some point in the future. Where infrastructure can generate secure revenue streams this is particularly attractive.

9 In what new ways could private finance be used to improve the delivery, management and performance of government-funded infrastructure projects?

Early engagement with investors could lead to innovative approaches to financing, as well as giving delivery a useful sense of focus. Investors will be keen to see any new assets to become productive at the earliest opportunity.

We could also consider the packaging of projects (eg flood defences, housing and public infrastructure) which when taken together could form a commercially compelling proposition. In this example, the flood defences would be a difficult proposition for private investment, but the development it would enable would be the prize.

10 What is your view on the effectiveness of the existing government tools to support the supply of infrastructure finance?

Government support for infrastructure, outside nationally significant schemes, is based around competitive bidding for relatively small pots of funding. This means that strategic approaches are not taken, replaced with opportune chasing. This leads to short term tactical projects, rather than delivery of a set of component projects contributing to an overall strategy which would have a much stronger benefit/return case.

11 Should the government change, expand or reduce the levers it uses to support the supply of infrastructure finance?

Expand. There needs to be a menu of options and approaches that are able to support a range of projects. We need to move away from short term, competitive processes that are typically over-subscribed many times over. This means that promoters chase the funding rather than use the funding to advance strategic objectives.

12 Should the government consider any alternative forms of finance support for sectors such as higher education or housing associations?

Yes. The EIB have supported housing associations and other enterprises, not just what would be considered to be traditional infrastructure. The EIB leaving the UK will leave a significant gap in the finance options available to these sectors.

Further Education should also be considered, not just higher education. There must be a new approach to funding and supporting this sector which is much more collaborative across a range of providers and programmes, and has a much more productive relationship with industry. Local pooling of apprenticeship levy could be a start, as could the development of new approaches to funding and using this to support investment in infrastructure.

There are significant capacity issues in the UK construction industry, and an increasing list of nationally significant projects and ambitious housing delivery targets. There could be interesting opportunities for financial support to grow the capacity of the sector.

The increasing role of the private sector rental model, and much longer tenancies, in the housing sector can also be used to support investment in the overall provision of housing.

13 Which sectors or types of infrastructure may need support from government to raise the finance they need, particularly in light of major technological changes?

The Government's role should be that of developing the platforms for growth. Investment in 5G is an excellent example where government investment could create a competitive advantage for the UK in the international marketplace, supported by private sector investment.

In addition, Government (both local and national) are in possession of a real richness in data which would have a role in future technological changes. This may create new types of asset, creating new platforms for growth, further extending the UK's attractiveness for investment.

14 In your view, how effective is the current institutional framework at ensuring good projects can raise the finance they need?

There needs to be a menu of options and approaches that are able to support a range of projects. We need to move away from short term, competitive processes that are typically over-subscribed many times over. This means that promoters chase the funding rather than use the funding to advance strategic objectives.

Consideration should also be given to the packaging of opportunities. Individual projects may not provide a compelling case for investment by themselves, but as part of a wider package (or an enabler of a wider package) tis could be a much more compelling commercial opportunity. This will require a range of institutions (locally, nationally, private, public) to work together to tell this story. This approach needs to be championed and facilitated.

We should also work with overseas investors to explore how we can more closely align with our own practices to make investment in the UK easier for them while still satisfying the need for transparency and good governance.

15 Is any reform to the UK's institutional framework needed to better provide support to the market?

Changes in political ideologies and election cycles do not generally provide a stable environment for long term infrastructure planning and investment. Investors will ideally seek a stake in what is being developed and the willingness of a Government to do this will be driven by their world views. We need to demonstrate a long term position.

There are also institutions within the UK (eg local authority pension funds) which may be ideally placed to invest in the UK's infrastructure but do not do so to a great extent at the moment. Work should be undertaken to explore why this is, and how we could unlock their investment power.

16 In the event that the UK loses access to the EIB, do you agree with the 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?

Yes. We should not simply replace EIB with a British equivalent. We could use the EIB model as a starting point, but from there develop an entity that works much more closely with the aims of the government. It should be open to a range of organisations for example allow local authorities, LEPs, Further education etc to access funding and encourage collaboration. It will need to be able to work in concert with the emerging UK Shared Prosperity Fund to realise improvements to productivity.

However, we should not create an entity or approach which has a cost to engagement. By illustration, the OJEU process is widely recognised to add to procurement costs (in effect a premium) and can act as a barrier for some to participation. While recognising the need for transparency and good governance, we need to be proportionate in the approach.

I trust this is helpful, and we are more than happy to discuss this further.

Yours Sincerely,

Kate Willard
Chair
Opportunity South Essex