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Financing the UK's infrastructure

When infrastructure is properly financed, planned, and prioritised the economic and social benefits always outweigh the initial costs. However during the current challenging economic climate securing the funding required for these projects has never been more difficult. At the same time with new power stations urgently required, and projects such as high speed rail supported by the main political parties, securing the capital to ensure timely delivery has never been more important.

The Institution of Civil Engineers believes that there is a strong case for a National Infrastructure Investment Bank (NIIB).

Background

In previous economic downturns, there has been a tendency for public and private investment in infrastructure to be severely cut back. This was primarily due to the dominance of direct public funding for delivering capital projects. Such a trend cannot be repeated this time around and in future years without risking long term damage to the UK economy and its ability to cope with the transition to a low carbon world that may take decades to repair. Also, the landscape of project funding has altered significantly from the regime that prevailed during previous downturns.

It is therefore vital that we find a means of ensuring that sufficient long term funding is available on a continuous basis and at acceptable rates to develop and maintain our transport, communications, energy, water and waste management networks. A National Infrastructure Investment Bank, working alongside other institutions can help deliver these goals.

A National Infrastructure Investment Bank

What is needed is a source of long term financing that supports projects that will strengthen UK competitiveness and help with the transition to a low carbon economy. A National Infrastructure Investment Bank (NIIB), initially capitalised by government and then able to use the government's AAA rating to raise funds on international markets can meet this need. The projects to which a NIIB lent would create valuable assets, further underpinning the bank's creditworthiness. We also believe that the presence of a vigorous NIIB, will help hold down the cost of capital across all infrastructure sectors.

The Nordic Model

A model to explore would be the Nordic Investment Bank. The Nordic Bank is owned by the governments of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden.

Its mission is to promote sustainable growth of its member countries by providing long-term complementary financing, based on sound banking principles, to projects that strengthen competitiveness and enhance the environment. The bank places a particular emphasis on investments in infrastructure and uses its position to lever in funds from small and large private investors.



Why must we maintain infrastructure investment?

Many commentators, including the Treasury itself have acknowledged that a historic under investment in infrastructure has held back the UK's economic performance.

The UK also needs new and upgraded infrastructure to deliver energy security, meet a range of international obligations and decarbonise our economy.

Efforts to rebalance the economy in the wake of the financial crisis will also need to be underpinned by an infrastructure fit for the 21st century. In this context, right-of-centre think tank Policy Exchange recently reported that on a conservative estimate, the UK will need to invest £434 billion in infrastructure by 2020.

Barriers to infrastructure investment

There are currently several significant barriers to effective public and private infrastructure investment, including:

- Enormous pressure on public finances. In the 2009 budget the Chancellor set out plans to reduce capital expenditure by 50% by 2013/14
- Higher costs of capital affecting PFI/PPP projects and private investment
- Low availability of funds as lenders rebuild their capital base
- Uncertainty over the future of public infrastructure projects and programmes leading to the engineering and construction industries shedding capacity, adding to long term costs

Current infrastructure investment possibilities

The NIIB provides a viable finance model currently poorly served by the alternatives. Below are the four main current sources of funds for infrastructure, with an explanation as to why they cannot provide reliable or adequate supply of funds:

- PFI/PPP has been a major means of delivering infrastructure, particularly for roads and waste management facilities. However current economic conditions have reduced the availability of private funds as banks have looked to repair their balance sheets. As a result the lending is taking place at a higher rate of interest, spread over shorter time periods, thus adding

to project costs. In addition the decline of the market for syndicated debt means that larger clubs of primary lenders are needed for each project, adding further to complexity and cost.

- The Treasury Infrastructure Finance Unit (TIFU) was created earlier this year to lend to PFI and now PPP projects struggling to secure funding on acceptable terms. TIFU, however, lends only to PFI/PPP projects and in doing so appears to undermine a key goal of PFI/PPP, paying the private sector to manage risks associated with infrastructure projects.
- The Public Works Loan Board was set up in 1793 and makes loans to Local Authorities and other statutory bodies. In 2008/9 it loaned circa £6 billion and has total outstanding loans of £50 billion. The PWLB is too small to deal with the scale of the UK's infrastructure needs and would be more effective if made part of a larger body. Equally, the current credit crisis has exposed the potential weakness of relying on 'prudential funding' as an option for funding infrastructure at local government level.
- The European Investment Bank made loans totaling circa £50 billion in 2007. Though a useful source of funds its focus is on EU wide priorities, as such there is a case for a complementary UK institution.

A solution

A National Infrastructure Investment Bank would ensure secure funding for long-term infrastructure investment with a much reduced impact on the shrinking public purse, and help ensure that vital infrastructure investment takes place. In addition, it will ensure that the aspirations and scope of the different infrastructure programmes currently promoted from different departments are better coordinated and aligned to achieve a more balanced development effort for the UK. It will also bring about greater efficiency through a reduction in the transaction cost associated with the funding of infrastructure projects.

ICE is continuing to develop the model for the National Infrastructure Investment Bank.

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