ICE submission to the Public Accounts Committee inquiry on the creation of the UK Infrastructure Bank

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Introduction

Established in 1818 and with over 96,000 members worldwide, the Institution of Civil Engineers exists to deliver insights on infrastructure for societal benefit, using the professional engineering knowledge of our global membership.

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Submission

Infrastructure investment

The ICE places a strong focus on infrastructure investment. In October 2018, ICE called for the examination of the feasibility of establishing a UK financial institution as a contingency against a loss of access to low-cost anchor finance from the European Investment Bank (EIB) and to maintain domestic expertise in infrastructure investment.

This was later explored through the HM Treasury and Infrastructure and Projects Authority Infrastructure Finance Review.

Whilst the private infrastructure finance market is broadly strong, there are areas where it might not be the best vehicle to deliver infrastructure projects. Some types of investors are unwilling, unable or lack the experience and skills to invest in certain types of projects or various stages of completion which could lead to gaps in provision.

Private finance favours stable and attractive returns and low risk. This might be particularly true for institutional investors and pension funds which tend toward prioritising long-term returns over short-term profit.

Lower risk projects tend to be concentrated in large population centres, that can provide a guaranteed revenue stream, and which have a strong economy. In a UK context this would tend to be London and the South East. Projects elsewhere may not have the footfall, or demand, to remain sustainable and lower population density would make delivery and maintenance of that infrastructure more expensive.

That is not to say that private finance would not support higher risk projects, but with a return-focused mindset and absent other imperatives, they would be less likely to do so. Even where the will is present, the increased interest requirements from projects with a higher risk profile might render them prohibitive.

A similar concern exists for new or untested technologies, where private appetite is limited. There is also an ongoing market failure in the built environment sector with regards to innovation. The role of the EIB and the Green investment Bank, as was, in supporting private finance to deliver offshore wind is a prime example of this.[1]

Concerns about the availability of finance, or perhaps the willingness to invest, from private sources during an economic downturn also call for institutions which can provide support where market conditions deteriorate.

Intervention, incentive, inducement or risk reduction efforts are therefore necessary to ensure private finance is directed toward such projects.

Finally, there is a need to maintain and expand the UK's expertise in financial management and technical delivery of projects, particularly major projects and programmes. A dedicated UK financial institution like the Bank will help to consolidate the considerable expertise available to the government already through the Infrastructure and Projects Authority, National Infrastructure Commission and other agencies and institutions.

Previous investment banks

The EIB provided significantly lower cost finance than the market average because of its credit rating backed by multiple governments, lack of commercial profit motive and wide portfolio which served to reduce risk. This enabled it to take more risks with innovative projects, which might otherwise struggle to raise finance, and support new and untested technologies and concepts that would not be able to access commercial markets, supporting innovation.

Moreover, the bank's focus on support for regional development and small and medium enterprises helped to address regional inequality and support businesses and projects which might otherwise have failed to access affordable finance.

Its role in de-risking projects improved the viability of projects seeking finance and encouraged additional liquidity in the market.

Whilst some might have concerns that the provision of cheaper capital, can act to crowd out finance from other sources, the role this plays in supporting otherwise unattractive projects helps to bring viable or 'good' projects to market and supports the business case for projects accessing this finance.

UK Infrastructure Bank

The above shows that the UK Infrastructure Bank will need to support development in less economically developed regions, or where the cost-benefit analysis might be low in economic terms, but high in social or environmental terms.

The bank's focus on economic infrastructure is welcome, as well as the fact the Bank can consider mixed projects with a significant economic element. The Bank itself has said it expects clean energy to be the largest sector in its portfolio given its importance to the UK's net zero and energy security goals, with the rest of its portfolio mostly targeted at transport and digital.

There are questions about how the Bank measures up against the EIB. As ICE set out in a response to the Infrastructure Finance Review, the EIB was a major inward investor of capital, providing key financing in developing success stories such as the UK's offshore wind market, alongside supporting regional growth in less developed parts of the country.

While funding from the EIB dried up in the aftermath of the 2016 referendum, it averaged approximately £5 billion of financing to UK projects every year before that.

[1] Green Investment Group (2017) Shaun Kingsbury on offshore wind: The coming of age of a new asset class

The Bank's £12 billion in capital over the next five years since it was set up in 2021 does look small in comparison. The Office for Budget Responsibility expects that the Bank will invest around £1.5 billion per year, after accounting for lending to local authorities that would have otherwise taken place through the Public Works Loans Board.

Confirmation from the Treasury that the UKIB will develop a specific advisory service for local authorities and other project promoters is welcome, as this can address capacity gaps and help ensure infrastructure projects address strategic objectives.

However, the fact this function is not yet fully operational means that many capacity building and funding constraint challenges being faced by local authorities are not yet being addressed.

UK Infrastructure Bank Bill and the National Infrastructure Strategy

The UK Infrastructure Bank Bill offers an opportunity to strengthen strategic decision-making.

One way would be to add a formal mechanism in the Bill for setting up and regularly updating the National Infrastructure Strategy (NIS), essentially placing the NIS on a statutory footing.

This would ensure the UK maintains an overall strategic infrastructure framework. In turn, this would guide long-term infrastructure planning and help the Bank make effective decisions.

The ICE has explored this issue further in a paper on evolving the UK strategic infrastructure planning system.[2]

Learning from other examples

Before its formal establishment, there was debate around the financial parameters of how the Bank should operate. The Canadian Infrastructure Bank, for example, has a negative return target to enable it to invest in more risky projects. This is in comparison to the UK Infrastructure Bank, which is expected to earn an annual return on equity of between 2.5% and 4% by 2025-26.

However, the Canadian experience is that their Bank is investing in 'low-hanging fruit' as well as riskier projects.

At an ICE roundtable on the scope and priorities of the UK Infrastructure Bank, there was an expectation that the Bank would operate satisfactorily if the expectations were for a modest return, with some loss-making on projects and a focus on crowding in investment rather than crowding out.[3]

However, delivering a balanced portfolio will require some investments that are 'straight down the middle' that others may perceive as crowding out. The Bank should realise that this accusation of crowding out will come whatever it does. If a project does not work because it isn't economically viable, that is something for government departments to consider for grant funding; the Bank should focus on value-adding, not becoming a grant-giving arm of the state.

However, the Bank can help in these circumstances by being a go-between, particularly for local authorities.

[2] ICE (2021) ICE policy position statement: evolving the UK strategic infrastructure planning system
[3] ICE (2021) Presidential Roundtable Summary: What should the scope and priorities be of the new UK Infrastructure Bank?