THE FUTURE OF THE EUROPEAN INVESTMENT BANK IN THE UK

Report by
The Infrastructure Forum's
EIB Working Group

TIF
THE INFRASTRUCTURE FORUM

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EXECUTIVE SUMMARY

1. This report seeks to ascertain the significance of the European Investment Bank's [EIB] contribution to the UK infrastructure market, both in terms of 'hard' and 'soft' benefits. It examines potential options for the way ahead.

2. The UK has a 16.1% value stake in the EIB, amounting to €39.2 billion in subscribed capital.[1] By Article 5 (1) of the *Statute of the European Investment Bank*, each member state is currently required to pay 8.9% of their value stake into the bank.[2] Accordingly, €3.49 billion of the UK's value stake has been called up and paid in.[3]

3. On Friday 8 December 2017, Michel Barnier and David Davis set out in the 'Joint Report from The Negotiators of The European Union and The United Kingdom Government', arrangements whereby Britain's capital stake would be repaid over a 12-year period and its obligation to respond to any limited calls restricted "paripassu" to its remaining stake if no other agreement was made.[4]

[1] European Investment Bank, *Financial Report*, 2016, p.47, [online] Available at: http://www.eib.org/attachments/general/reports/fr2016en.pdf (accessed 3/1/18).
[2] European Investment Bank, *Statute and other Treaty provisions*, 1 July 2013, p.9, [online] Available at: http://www.eib.org/attachments/general/statute/eib_statute_2013_07_01_en.pdf (accessed 15/9/17).
[3] European Investment Bank, *Financial Report*, 2016, p.47.
[4] See: Negotiators of the European Union and the United Kingdom of Great Britain and Northern Ireland, *Joint Report from The Negotiators of The European Union and The United Kingdom Government on Progress During Phase 1 Of Negotiations Under Article 50 TEU on the United Kingdom's Orderly Withdrawal from The European Union*, 8 December 2017.

4. 1,410 UK projects have been financed over the course of the EIB's history. This amounts to €117.3 billion in finance received for the UK infrastructure market over a 44-year period.

5. The European Fund for Strategic Investments [EFSI] is a supplementary initiative launched jointly by the EIB and European Investment Fund [EIF].[5] Since its establishment in 2015, the EFSI has signed €1.9 billion in guarantees to projects either solely or partly benefitting the UK, and contributed to many intermediary equity funds.

6. EIB investment in UK projects peaked in 2015 at €7.8 billion.[6] Subsequently, however, there has been a significant decline in EIB lending to the UK. The amount of financing received by the UK in 2016 was €5.2billion.[7] Uncertainty on the UK's future relationship with the EU has significantly affected EIB lending. UK projects either under appraisal or approved but not yet signed by the EIB are currently awaiting for €4.6 billion.[8]

7. The Infrastructure Forum conducted a series of structured interviews with users and potential users of EIB finance which has helped to assess views of the EIB's value to the UK. Responses indicated that were the UK's membership of the EIB to cease, the UK would lose a number of hard and soft benefits.

   I. The UK would **lose an element of subsidised lending.**

   II. The EIB acting as a **cornerstone lender**.

   III. The EIB promoting **crowding in of new technologies**.

   IV. During times of market contraction, the EIB continues to lend, **stabilising markets**.

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[5] European Investment Bank, *What is the European Investment Fund for Strategic Investment (EFSI)?*, 2017, [online] Available at: http://www.eib.org/efsi/what-is-efsi/index.htm (accessed 5/12/17).
[6] European Investment Bank, *Project Loans*, 2017, [online] Available at: http://www.eib.org/products/lending/loans/index.htm (accessed 12/10/17).
[7] Ibid.
[8] European Investment Bank, *Projects to be financed*, [online] Available at: http://www.eib.org/projects/pipelines/index (accessed 20/11/17).

V. In periods of tight liquidity, the EIB has been **central to keeping financing streams open for projects**.

VI. The EIB also offers **reassurance to foreign investors** on default risk. This is especially true in large syndications, where its experienced teams can lead negotiations.

VII. The market share of the EIB is sufficiently small that it is **rarely in danger of crowding out investors**. Instead it acts to support those projects that might not otherwise have been funded.

VIII. The EIB provides loans with **longer tenors** than the private sector.

IX. EIB loans offer significant **flexibility**. Loans can be:

   a. Drawn down in tranches
   b. Issued in different currencies
   c. Issued at either fixed or variable interest rates

X. The EIB has **scale and reach** unmatched by many other lenders.

XI. EIB offers are well **tailored and appropriate** for the associated risks, as each project is subject to individual assessments, often more rigorous than those conducted by other lenders.

XII. The EIB has **strong technical due diligence** practices.

XIII. The strict conditions attached to EIB lending ensure its finance supports projects of **social purpose** and upholds its **sustainability agenda**.

XIV. The EIB is **willing to look at greenfield risk**, supporting new build and assisting business expansion across the Union and globally.

8. Interviewees did however note that EIB **due diligence processes are lengthy** and often **difficult to navigate** successfully; and the EIB is perceived by some to **lack transparency**, making it difficult to understand what conditions must be met for loan approval.

9. Having considered the views of industry users and potential users of EIB loans, five options for the UK's future relationship with the EIB emerged:

   a. **Remain a full member of the EIB**

   This would offer the UK a seat at the table and voting rights, preserving the status quo. To do so would involve amending Article 308 of the *Treaty on the Functioning of the European Union* which currently restricts membership of the EIB to EU member states.

   b. **Become a member of EFTA**

   Joining the European Free Trade Association [EFTA] as a European Economic Area [EEA] member would mean the UK could continue to apply for and receive EIB funding on similar terms to those which currently prevail. This would address the uncertainty currently stalling UK loan applications and ensure that future projects could be considered for finance.

   EFTA countries are presently the largest non-EU recipients of EIB loans. Projects in these countries accounted for 4% of loan signatures in 2016;[9] almost half of all signatures on projects in non-EU countries.

   c. **Establishing a third-country agreement**

   EIB lending to third countries occurs on the basis of an agreement which extends certain rights and privileges as well as processes and procedures between EIB and member states of the EU to third countries. This would offer a means for UK

[9] European Investment Bank, *Financial Report*, 2016, p.3.

projects to engage in EIB finance, without a broader agreement with the EIB being implemented.

d. A domestic solution

There are a number of interventions in the domestic infrastructure market that the UK Government could consider to fill the role of the EIB.

The UK Guarantees Scheme [UKGS] could be enhanced to offer limited guarantees for projects during the construction period, in which most risk is encountered. In addition, under the *Infrastructure (Financial Assistance) Act 2012*, HM Treasury can provide financial assistance to any person for the provision of infrastructure.[10] The UKGS, as a scheme jointly run by HM Treasury and the Infrastructure and Projects Authority, could provide *loans* up to £50 billion to infrastructure projects on this basis. Such a combination of guarantee and lending powers could make the UKGS a particularly useful replacement for EIB lending and would minimise disruption, if implemented, as the scheme already exists.

Extending the mandate of the Public Works Loan Board [PWLB] to allow it to issue loans to domestic infrastructure projects could be another alternative. Setting up a similar institution to the PWLB, specifically for infrastructure projects within the Debt Management Office would also add value.

Utilising the existing British Business Bank [BBB] to promote greater investment in infrastructure through its 90 partners would fill some of the liquidity gap.

A further option would be to create a new British Investment Bank [BIB], which could provide the soft benefits of the EIB, such as its role as a cornerstone investor with subsidised and long-term lending. As a domestic rather than

[10] Infrastructure (Financial Assistance) Act 2012, HL Bill 43, 55/2. 1.2, [online] Available at: https://publications.parliament.uk/pa/bills/lbill/2012-2013/0043/2013043.pdf (accessed 14/12/17).

supranational lender, it could though be subject to political disagreement both concerning its structure and role, and potentially its lending decisions.

e. No relationship with the EIB or implementation of a UK replacement solution

10. If therefore the UK infrastructure sector is not to be negatively impacted a clear decision on its future financing will be necessary in good time ahead of the UK ceasing to be a member of the EU.

11. It would be beneficial for the UK to remain a full member of the EIB with a presence on its board, a stake in its capital and the ability to play a full part in shaping its future policies; and by this status continuing to receive a disproportionate share of EIB lending.

12. Both joining EFTA/EEA member or signing a third-country agreement with the EIB seems to offer a promising way of maintaining a connection which has served the UK well, if a Treaty change is not possible to achieve.

13. Of the domestic possibilities to replace EIB lending we believe that it would be best to build on existing institutions, because of their familiarity to markets, their ability to increase lending relatively quickly, with continuity and relatively low transition cost. Significant expansion of the UKGS and utilising its capacity to provide loans for infrastructure projects, under the Infrastructure (Financial Assistance) Act 2012,[11] could make the UKGS a particularly useful replacement.

14. Establishing a BIB has been considered various times over the decades with some well-known downsides, primarily that the entity becomes prone to excessively centralised planning of the economy. The perceived political control of such a bank may deter borrowers and co-investors of which the EIB has been free from due to its supranational status and its place as an institution of the EU.

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[11] Infrastructure (Financial Assistance) Act 2012, HL Bill 43, 55/2. 1.2.

14. Following the result of the UK's referendum on EU membership and the triggering of Article 50 in March 2017, the future of the EIB's role in the UK is uncertain.

15. As an EU-member state, the UK is a member of the EIB by virtue of Article 3 of the Statute of the European Investment Bank.[12] Therefore, without a Treaty change, upon the cessation of its EU membership, the UK will not qualify for membership of the EIB.

16. This report seeks to ascertain the significance of the EIB's contribution to the UK infrastructure market, both in terms of 'hard' and 'soft' benefits. It examines potential options for the way ahead.

17. It is important to note that this report has *not* taken into account the wider political factors related to the Brexit negotiations, in order to consider all of the options available for the UK's future relationship with the EIB.

[12] European Investment Bank, *Statute and other Treaty provisions*, 1st July 2013, p.7.

ROLE OF THE EIB IN THE UK INFRASTRUCTURE MARKET

THE UK INFRASTRUCTURE MARKET

18. The Infrastructure and Projects Authority's [IPA] National Infrastructure Pipeline, published Autumn 2017, valued the UK's infrastructure pipeline at £57.77 billion for the year 2016/17.[13] In the same year, the EIB provided €5.2 billion in loans to UK projects.

THE UK AND THE EIB

19. The UK has a 16.1% value stake in the EIB, amounting to €39.2 billion in subscribed capital.[14] By Article 5 (1) of the *Statute of the European Investment Bank*, each member state is currently required to pay 8.9% of their value stake into the bank.[15] Accordingly, €3.49 billion of the UK's value stake has been called up and paid in.[16]

20. 1,410 UK projects have been financed over the course of the EIB's history. This amounts to €117.3 billion in finance received for the UK infrastructure market over a 44-year period.

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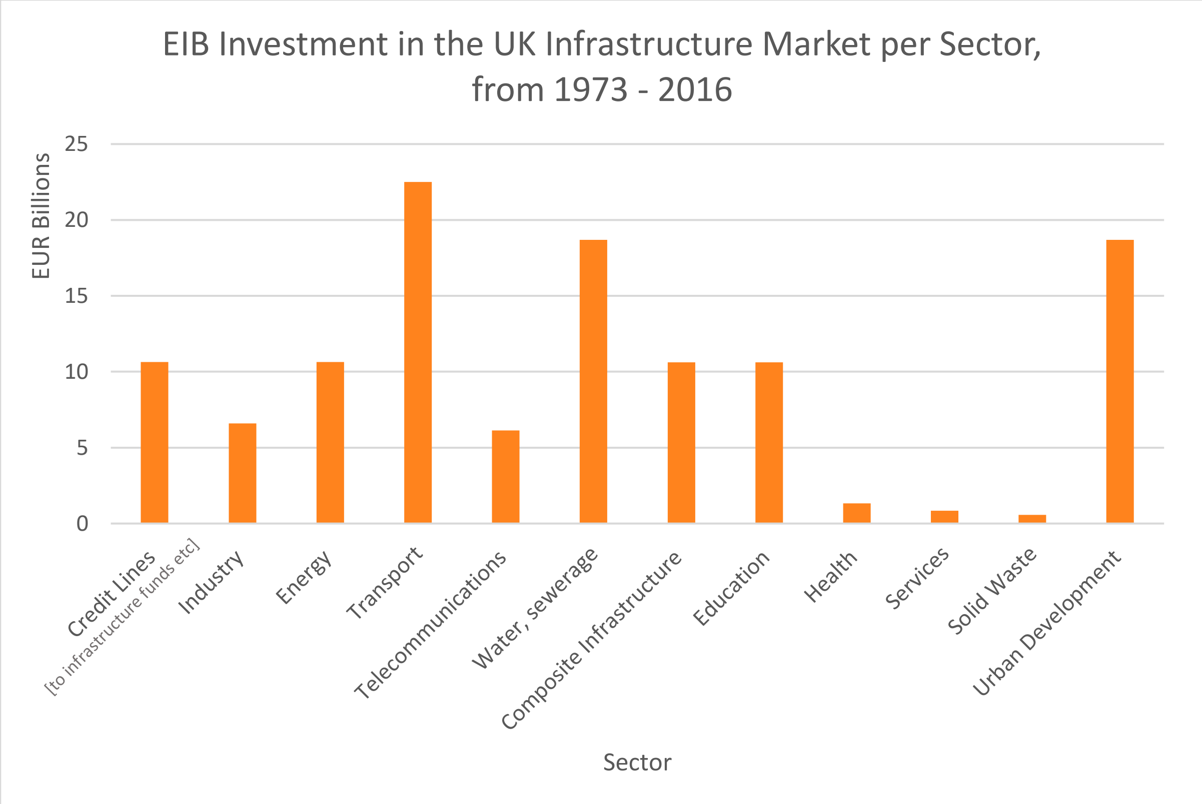
[13] HM Treasury and Infrastructure and Projects Authority, *National Infrastructure and Construction Pipeline 2017*, 2017, [online] Available at: https://www.gov.uk/government/publications/national-infrastructure-and-construction-pipeline-2017 (accessed 19/12/17).

[14] European Investment Bank, *Financial Report*, 2016, p.47.

[15] European Investment Bank, *Statute and other Treaty provisions*, p.9.

[16] European Investment Bank, *Financial Report*, 2016, p.47.

21. In terms of the EIB's investment per sector in the UK, energy and transport had received the greatest proportion of EIB funding to the UK between the commencement of funding in 1973 and 2016 – see figure 1.



[17]

Figure 1

[17] European Investment Bank, *Project Loans*, 2017.

22. Article 20 of the EIB Statutes provides that “The Bank shall borrow on the capital markets the funds necessary for the performance of its tasks.”[18] This supplies the necessary capital to finance the lending activities of the Bank and its other cashflow needs, including prefunding of the 2017 borrowing programme.[19] Therefore, the value stakes of EIB member-states *back* EIB loans, they *do not provide the funds* for investment.

23. The EIB maintains an AAA credit rating,[20] enabling it to seek such finance from capital markets and act as the World’s largest multilateral lender. €66.4 billion was raised on capital markets in 2016, with disbursements in 2016 totalling €60.4 billion.[21]

24. The bank lends to projects with the intention of furthering EU policy goals. Specifically, it focuses on four areas: innovation and skills, SMEs, climate action, and strategic infrastructure.[22]

EUROPEAN FUND FOR STRATEGIC INVESTMENTS

25. The European Fund for Strategic Investments [EFSI] is an initiative launched jointly by the EIB and European Investment Fund [EIF].[23] The EIF is part of the EIB Group and responsible to both the EIB and European Commission. In its own capacity it provides finance to small and medium-sized enterprises [SME’s].

26. EFSI targets projects with a higher risk profile than would receive funding under the EIB’s general criteria. Specifically, the European Commission identified that the transport, energy

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[18] European Investment Bank, *Statute and other Treaty provisions*, 2013, p.19.
[19] European Investment Bank, *Financial Report*, 2016, p.4.
[20] The European Investment Bank, *Credit Rating*, 2017, [online] Available at: http://www.eib.org/investor_relations/rating/index.htm (accessed 15/9/17).
[21] European Investment Bank, *Financial Report*, 2016, p.8.
[22] D. Revoltella, ‘EU Challenges, Investment in the EU and the Role of the European Investment Group,’ *Intereconomics*, 2016, p.6.
[23] European Investment Bank, *What is the European Investment Fund for Strategic Investment (EFSI)?*, 2017.

and information and communication technology sectors would need as much as €2 trillion to reach its Europe 2020 objectives.

27. EFSI offers guarantee finance, with the intent of mobilising additional private sector finance to infrastructure projects and SME's. Its lending activities are reported separately from those of the EIB.[24] It has total available financing of €61 billion.[25]

28. Since its establishment in 2015, the EFSI has signed €1.9billion in guarantees to projects either solely or partly benefitting the UK, and contributed to many intermediary equity funds. This constitutes a significant additional contribution of the EIB towards the UK infrastructure market. For example, the EFSI provided €48 million in financing for the Calvin Smart Meter Roll-out in May 2016, as well as €714 million to the Beatrice Offshore project (an offshore windfarm off the coast of Scotland).[26] See *Annex 1* for a complete list of EFSI signed projects in the UK.

29. The EFSI's Project Bond Initiative was proposed in 2010 and adopted in the Summer of 2012 by the European Commission and the EIB. It "is designed to enable eligible infrastructure projects promoters, usually public private partnerships (PPP), to attract additional private finance from institutional investors such as insurance companies and pension funds."[27]

30. The initiative is intended to fill the funding gap for projects with below BBB credit ratings. It aims to "stimulate capital market financing for large-scale infrastructure projects" specifically in the areas of transport, energy and communication technology.[28] It does so by

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[24] European Investment Fund, *How does EIF contribute to EFSI*, 2016, [online] Available at: http://www.eif.org/what_we_do/efsi/how_does_EIF_contribute/index.htm (accessed 3/1/18).
[25] European Investment Bank, *What is the European Fund for Strategic Investments (EFSI)?*, 2017.
[26] European Investment Bank, *EFSI Project List*, 2017, [online] Available at: http://www.eib.org/efsi/efsi-projects/index.htm (accessed 12/10/2017).
[27] European Investment Bank, *The Europe 2020 Project Bond Initiative - Innovative infrastructure financing*, 2017, [online] Available at: http://www.eib.org/products/blending/project-bonds/index.htm (accessed 5/12/1/7).
[28] Ibid.

dividing debt into two tranches: subordinated and senior.[29] The former is issued immediately in the form of a loan from the EIB, with the support of the EC. Senior bonds are then issued by the company itself, with the underlying Project Bond Credit Enhancement [PBCE].[30] The subordinated debt is repaid after senior bonds, thus private investors, such as pension funds and insurance companies, are reassured by the enhanced credit rating.[31]

[29] European Investment Bank, The Europe 2020 Project Bond Initiative - Innovative infrastructure financing, 2017.
[30] Ibid.
[31] European Investment Bank, *An outline guide to Project Bonds Credit Enhancement and the Project Bond Initiative*, 21 December 2012, p.4, [online] Available at: http://www.eib.org/attachments/documents/project_bonds_guide_en.pdf (accessed 12/10/17).

A CHANGING ATTITUDE TO UK LENDING

31. As Figure 2 shows, the total EIB investment each year in UK projects steadily increased since 1973. There was a notable increase in funding received from 2012 to 2015, from €3.6billion to a peak of €7.8 billion.[32]

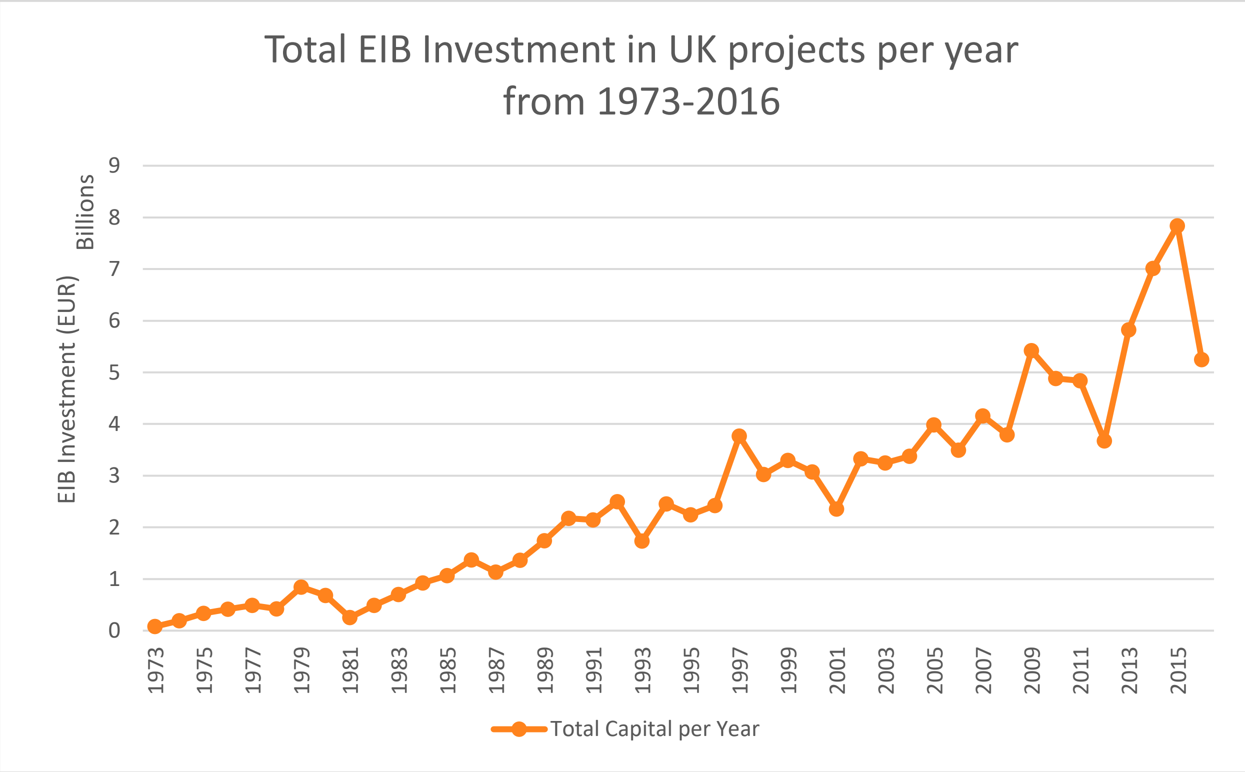

Figure 2

[32] European Investment Bank, *Project Loans*, 2017.

32. Subsequently however, there has been a de facto standstill on EIB lending to the UK, and the amount of financing received by the UK in 2016 declined to €5.2billion.

33. The President of the EIB said in October 2017 that recent levels of EIB finance "cannot be maintained".[33] He said, as quoted in the Financial Times:

> "I foresee developments in the [Brexit] negotiations that will make it not easier to continue with lending decisions because these will have to be taken not by the management of the bank at the end of the day, but on our proposals by representatives of the member states."[34]

34. Many believe that EIB finance to the UK has stalled because of the uncertainty concerning the UK's future relationship with the EU. This uncertainty has not only affected present lending of the EIB but its ability to issue new loans.

35. Borrowers believe that the freezing of UK projects results from EIB uncertainty about whether the UK will continue to be a shareholding member of the Bank post Brexit and what will be the position regarding its privileges and immunities in the UK in the future. These privileges and immunities, in common with those attaching to other EU institutions and agencies, result directly from the UK's EU membership. This uncertainty as to what will happen in the future is noted in the UK Government position paper on privileges and immunities published in July 2017 which says, "The UK stands ready to give specific consideration to the rights enjoyed by the European Investment Bank under Protocol 5 to facilitate the conduct of its operations, as part of an overall settlement on the Bank".[35]

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[33] C. Giles, 'EIB chief warns UK will struggle without cheap EU loans', *The Financial Times*, 10 October 2017, [online] Available at: https://www.ft.com/content/5494d5ea-8e0d-11e6-8df8-d3778b55a923 (accessed 25/10/17).
[34] Ibid.
[35] HM Government, *Privileges and Immunities - Position Paper*, 13 July 2017, p.3, [online] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/627908/FINAL_HMG_Privileges_and_immunities_Position_PapeR.pdf (accessed 17/11/17).

36. Another reason for the current standstill is believed to be EIB uncertainty about the future implementation in the UK of environmental, social, labour market and other policies which currently arise from the UK's membership of the EU, but which might change in the future. It is possible to imagine that the EIB would in the future wish to amend documentation for UK lending to ensure conformity with requirements arising from the EU *acquis*; in a form of regulatory alignment.

37. Presently, there is £4.6 billion in the pipeline of UK projects awaiting EIB finance.[36] This includes both those loans 'under appraisal' and those 'approved but not yet signed' for projects in urban development, energy, water, transport, health and waste. It is understood while no UK applications have been formally refused, in practice many seem to be no longer moving forward in EIB processes.

UK GOVERNMENT REACTION TO UNCERTAINTY

38. The uncertain future status of the UK's membership of the EIB was recognised by the Chancellor in his 2017 Mansion House Speech:

> "The European Investment Bank, and its offshoot, the European Investment Fund, have been an important source of funding for infrastructure investment and for growth businesses.
>
> I want that access to EIB funding to continue while we are members of the EU on equal terms, so I am engaged with EIB and will provide the assurances it needs to sustain the flow of EIB and EIF funding to UK businesses and projects.

[36] European Investment Bank, *Projects to be Financed*, 2017.

And to ensure that finance continues to be available after Brexit, alongside these discussions with the EIB I can also announce I am expanding the support available to capital funding in the UK."[37]

39. HM Treasury had been receiving increasing demands for market intervention in the infrastructure industry due to this and the Chancellor announced the following:

"For infrastructure projects, we will broaden the range of the UK Guarantees Scheme by offering construction guarantees for the first time.

And we'll consider other credit enhancement tools, such as first loss guarantees, to reduce the financial risk that complex projects face.

To support the venture capital funds that are so important to growth and innovation in our economy, the British Business Bank will raise the limits on the amount it can invest in venture capital funds from 33% up to 50%.

And it will be able to bring forward some of the £400m additional investment that I announced at the Autumn Statement."[38]

40. The Government further announced in August 2017 the intention to expand the National Investment Fund, which aims to help cutting-edge start-ups.[39]

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[37] HM Treasury and The Rt Hon Philip Hammond MP, 'Mansion House 2017: Speech by the Chancellor of the Exchequer', 20 June 2017, [speech] Available at: https://www.gov.uk/government/speeches/mansion-house-2017-speech-by-the-chancellor-of-the-exchequer (accessed 20/11/17).
[38] Ibid.
[39] HM Treasury and The Rt Hon Philip Hammond MP, *New National Investment Fund to back innovative UK firms*, 1 August 2017, [online] Available at: https://www.gov.uk/government/news/new-national-investment-fund-to-back-innovative-uk-firms (accessed 12/10/17).

41. The Chancellor also announced an increase in the size of the National Productivity Investment Fund in the Autumn 2017 Budget from £23billion to £31billion.[40] Chiefly, this is to facilitate the Government's Industrial Strategy. £1.7 billion of this has been dedicated to a new transforming cities fund which aims to improve connectivity and support jobs across England's great city regions, by developing transport infrastructure.[41]

THE UK'S CAPITAL IN THE EIB

42. The potential sums at stake were the UK to cease to be an EIB member have been examined by the House of Lords European Union Committee. It concluded that:

> "The Statute of the European Investment Bank, and the Treaties, state that its members are limited to EU Member States. Unless the 27 remaining Member States were to agree unanimously to amend this rule the UK would have to leave the EIB upon Brexit, losing access to around £5 billion per year in financing. The UK might expect its €3.5 billion in called up capital to be returned if it ceased to be a shareholder. Based on the current net worth of the EIB, the UK may be due a share of equity in the region of €10 billion."[42]

43. On Friday 8 December 2017, Michel Barnier and David Davis set out in the 'Joint Report from The Negotiators of The European Union And The United Kingdom Government', arrangements whereby Britain's capital stake would be repaid over a 12 year period and its obligation to respond to any limited calls restricted "paripassu" to its remaining stake.[43]

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[40] HM Treasury, *Autumn Budget 2017*, 22 November 2017, [online] Available at: https://www.gov.uk/government/publications/autumn-budget-2017-documents/autumn-budget-2017 (accessed 6/12/17).

[41] Ibid.

[42] House of Lords Official Report, *Brexit and the EU Budget*, Authority of the House of Lords, 4 March 2017, p.27, [online] Available at: https://publications.parliament.uk/pa/ld201617/ldselect/ldeucom/125/125.pdf (accessed 11/10/17).

[43] See: Negotiators of the European Union and the United Kingdom of Great Britain and Northern Ireland, *Joint Report from The Negotiators of The European Union and The United Kingdom Government on Progress During Phase 1 Of Negotiations Under Article 50 TEU on the United Kingdom's Orderly Withdrawal from The European Union*, 8 December 2017.

44. It was agreed that in the eventuality of the UK leaving the EU without a further agreement in place, the following would apply:

> "The UK share of the paid-in capital will be reimbursed in twelve annual instalments starting at the end of 2019. The UK remains liable for the reimbursed amount of paid-in capital until the outstanding stock of EIB operations equals the total paid-in capital on the date of withdrawal, at which point the liability will start to be amortised in line with the remaining non-amortised operations.
>
> Apart from these reimbursements, the EIB will not make any other payment, return or remuneration on account of the withdrawal of the UK from the EIB or on account of the provision by the UK of a guarantee.
>
> Any call to the callable guarantee or the paid-in (cash or guarantee) will be "paripassu" with calls on or payments made by the Member States provided that it is used for covering operations at the withdrawal date or for covering risks (such as ALM (Asset-Liability management) risks or operational risks) attributable to the stock of operations at the date of withdrawal. For other such risks not associated with specific loans and not attributable to the stock of operations built after the date of withdrawal, the UK responsibility will be proportional to the ratio between the stock of outstanding operations and the total amount of operations at the date of the event."[44]

[44] Negotiators of the European Union and the United Kingdom of Great Britain and Northern Ireland, *Joint Report from The Negotiators of The European Union and The United Kingdom Government on Progress During Phase 1 Of Negotiations Under Article 50 TEU on the United Kingdom's Orderly Withdrawal from The European Union*, 8 December 2017, p.13.

45. What gaps would result from an end to EIB lending? The issue was examined in a report by CEPA for the National Infrastructure Commission [NIC].[45]

46. The report highlighted that "While the EIB has been involved in a number of transactions this does not necessarily mean that they would not have reached financial close without its involvement. EIB can play an important role in providing confidence to other lenders in a project. However, it can also provide cheaper credit than commercial providers, as such there can be questions about the extent to which the EIB is truly catalytic or whether its role is largely one of reducing the cost of finance faced by projects (and as a result either reducing user charges and/or boosting equity returns)."[46]

47. The report noted that "in the absence of a UK development finance counterpart, or the wider deployment of the UKGS [UK Guarantees Scheme],… *at a minimum* the cost of finance for a typical project will be bigger than it would have been with EIB participation."[47]

48. In its interim report 'Congestion, Capacity, Carbon: Priorities for National Infrastructure', the NIC added "There may be further implications for levels of investment in infrastructure in new and 'risky' sectors."[48]

49. The Infrastructure Forum conducted a series of structured interviews with users and potential users of EIB finance which has helped to assess views of the EIB's value to the UK.

[45] Cambridge Economic Policy Associates Ltd (CEPA), *Financing For Infrastructure*, 10 February 2017, [online] Available at: https://www.nic.org.uk/publications/review-infrastructure-financing-markets-report-nic/ (accessed 18/10/17).
[46] Ibid., p.63.
[47] Ibid., p.34.
[48] National Infrastructure Commission, *Congestion, Capacity, Carbon: Priorities for National Infrastructure*, 13 October 2017, [online] Available at: https://www.nic.org.uk/publications/congestion-capacity-carbon-priorities-for-national-infrastructure/ (accessed 18/10/17).

These discussions have informed the evaluation set out below. A detailed summary of stakeholder interviews is available at *Annex 2*.

50. Were the UK's membership of the EIB to cease, it would lose a number of hard and soft benefits:

    I. The EIB provides long-term funding at low cost. Hence, the UK would **lose an element of subsidised lending** for the infrastructure market. The Bank lends to individual projects with total investment costs that exceed €25 million, as well as directly to small and medium sized companies, where the loan requested is above €7.5 million.[49] For the latter, the loss of subsidised lending could be detrimental to the success of projects.

    II. It acts as a **cornerstone investor** on higher risk projects; it can offer up to 50% of the financing needed.[50]

    III. The EIB promotes **crowding in of new technologies**, by providing a reassuring presence to investors. This has been evidenced by the early EIB investment into offshore wind.

    IV. Further, during times of market contraction, the EIB continues to lend, **stabilising the markets**.

    V. In periods of tight liquidity, the EIB has been central to **keeping financing streams open for projects**.

[49] European Investment Bank, *Project Loans*, 2017.
[50] Ibid.

VI. The EIB also **offers reassurance to foreign investors** on default risk. This is especially true in large syndications, where its **experienced teams** can lead negotiations.

VII. The market share of the EIB is sufficiently small that it is rarely in danger of crowding out investors. Instead, it acts as support to those projects that might not have otherwise been funded.

VIII. The EIB provides loans with **longer tenors** than the private sector. This removes refinancing risk after the construction phase of the project. Finance can be agreed for periods from 36 months to 30 years, which is vital to developing an infrastructure pipeline.

IX. EIB loans offer significant flexibility. Loans can be:

  i. **drawn down in tranches** over the period agreed, rather than companies having to take the loan as an upfront lumpsum. This can help treasury teams with balance sheet management.
  ii. Issued in **different currencies**
  iii. Issued at either **fixed or variable interest rates**. Rates on future tranches can be forward fixed.
  iv. Subject to interest rate changes during their life at predetermined dates or during predefined periods at the discretion of the EIB.

X. It has a **scale and reach** unmatched by any other lender. The **expertise** the EIB has gathered across nations and sectors can be used holistically to improve infrastructure finance on a multinational scale.

XI. EIB offers are well tailored and appropriate for the associated risks, as each project is subject to individual assessments, often more rigorous than those conducted by other lenders.

XII. The EIB has **strong technical due diligence** practices.

XIII. The strict conditions attached to EIB lending ensure its finance supports projects of **social purpose** and upholds its **sustainability agenda**.

XIV. The EIB is willing to look at **greenfield risk**, supporting new build and assisting business expansion across the Union and globally.

51. Interviewees did however note some disadvantages of dealing with the EIB compared to commercial lenders.

    a. EIB **due diligence processes are lengthy** and often **difficult to navigate** successfully.
    b. EIB **processes can be seen as opaque**, making it difficult to understand what conditions must be met for loan approval.

52. Having considered the views of industry users and potential users of EIB loans, five options for the UK's future relationship with the EIB will be addressed.

1. REMAIN A MEMBER OF EIB POST-BREXIT

53. The EIB has provided, over 4 decades, finance for UK infrastructure on a significant scale. Many consider the ideal to be the continuation of this relationship. Remaining a full member with a seat at the table and voting rights would preserve the status quo.

54. This would involve amending Article 308 of the *Treaty on the Functioning of the European Union* which currently restricts membership of the EIB to EU member states.[51]

55. As suggested by the House of Lords European Union Committee, a treaty change allowing non-EU members to become members of the EIB could position the EIB more as a regional investment fund. Dr Ferrer, Senior Research Fellow at the Centre for European Policy Studies, proposed: "Could we open the door to a more regional model? We could to some extent, also allowing Iceland or Norway to join would be good for the EIB. The committee thought that "Retaining the UK stake could be the more financially straightforward option, although it would be politically and legally more complex."[52]

[51] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, 2012/C 326/01, Section 2, Chapter 4, Article 308, [online] Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT (accessed 19/12/17).
[52] Ibid.

2. JOIN THE EUROPEAN FREE TRADE ASSOCIATION

56. EFTA is composed of Iceland, Liechtenstein, Norway and Switzerland; however, only Iceland, Liechtenstein and Norway opted to become members of the EEA under the EEA Agreement.[53]

57. EFTA members are subject to the same obligations as their EEA counterparts according to the agreement: "The EEA agreement guarantees equal rights and obligations within the Internal Market for individuals and economic operators in the EEA."[54] Therefore, the conditions required by the EIB to lend to projects are automatically applied to EIB loans for EFTA/EEA countries.

58. EFTA countries are presently the largest non-EU recipients of EIB loans. Projects in these countries accounted for 4% of loan signatures in 2016;[55] almost half of all signatures on projects in non-EU countries.

59. Joining EFTA after exiting the EU as an EFTA/EEA state would mean the UK could continue to apply for and receive EIB funding on similar terms such to those which currently prevail. Such a relationship could address the uncertainty currently stalling UK loan applications to the EIB and ensure that future projects could also be considered for EIB finance. Specifically, uncertainty regarding privileges and immunities conditions would be resolved.

60. EFTA countries benefitted from 331 EIB loan signatures in 2016,[56] whereas 6,963 loans to UK projects were signed.[57]

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[53] EFTA, *EEA Agreement*, 2017, [online] Available at: http://www.efta.int/eea/eea-agreement (accessed 23/11/17).
[54] Ibid.
[55] European Investment Bank, *Financial Report*, 2016, p.3.
[56] Ibid., p.8.
[57] Ibid.

61. Such an arrangement seems a potentially viable alternative to the UK seeking renegotiation of Article 308 of the *Treaty on the Functioning of the European Union* in order to retain membership with the EIB.

3. A THIRD-COUNTRY RELATIONSHIP WITH THE EIB

62. All EU member states are members of the EIB by virtue of Article 308 of the *Treaty on the Functioning of the European Union*;[58] however, the EIB also issues loans to projects in countries that are *not* member states.

63. In 2016, 10% of signatures on EIB loans were to projects in non-EU countries.[59] By way of comparison, UK projects alone constituted 9% of all EIB loan signatures in 2016.[60]

64. EIB lending to third countries (i.e. non- EU member states) occurs on the basis of an agreement which extends certain rights and privileges as well as processes and procedures between EIB and member states of the European Union to third countries. Typically, this agreement will either be a framework agreement between EIB and the third country, or the third country will be a party to the Cotonou Agreement,[61] which is a partnership agreement between the EU and 79 developing countries in the African, Pacific and Caribbean regions.

65. The Cotonou Agreement, signed in June 2000, enabled the EIB to invest €765m in 29 projects across sub-Saharan Africa, the Caribbean and the Pacific, and Overseas Countries and Territories in 2016.

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[58] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, 2012/C 326/01, Section 2, Chapter 4, Article 308.
[59] European Investment Bank, *Financial Report*, 2016, p.3.
[60] Ibid., p.8.
[61] See: European Commission, *The Cotonou Agreement*, 22 June 2010, [online] Available at: https://ec.europa.eu/europeaid/sites/devco/files/cotonou-agreement_en.pdf (accessed 3/1/18).

66. Where a framework agreement or the Cotonou Agreement is used to allow EIB to engage in activities in a third country, the agreement will, amongst other things:

   a. establish the Bank's right to engage in activities in the third country that it is allowed to engage in in EU member states under its statute;

   b. confirm that the Bank is not subject to taxation or currency control in the third country when engaging in its permitted banking activities;

   c. provide rights, privileges, protection and immunities for the Bank and its assets, the projects the Bank funds and the Bank's staff in the third country;

   d. establish a mechanism for the third country to agree to the Bank's activities inside its territory; and

   e. establish dispute resolution mechanisms for (i) disputes arising with third countries about Projects funded by the Bank and (ii) between the Bank and the third country about the framework agreement.

67. Establishing a third-country agreement would offer a means for UK projects to engage in EIB finance, without a broader agreement with the EIB being implemented.

68. Some templates do exist for guidance on how to establish a third-country relationship with the EIB. For example, in 2014 the EIB published 'EIB template contractual clauses on environmental matters',[62] outlining how environmental standards should be included in non-EU country project agreements. These templates could be used to develop contracts covering UK projects.

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[62] See: European Investment Bank, *EIB template contractual clauses on environmental matters*, 2014, [online] Available at: http://www.eib.org/attachments/documents/eib_standard_contractual_clauses_on_environmental_information_en.pdf (accessed 23/11/17).

69. The EIB is in the preliminary stages of developing a new fund similar to the EIF, in which it would provide funding to projects in third countries with interests aligned to the EIB.[63] This may be available to a non-EU UK; however, it is primarily intended for development purposes.

4. POSSIBLE DOMESTIC SOLUTIONS

70. If no agreement between the UK and the EIB can be reached as to its future relationship, this report has suggested that a funding gap will arise in the UK infrastructure market. Consequently, it is prudent that the UK offers a domestic solution that could offer at least similar benefits to EIB loans. Industry respondents suggested this would at minimum be required in a Brexit transition period.

Extended UK Guarantees Scheme

71. The UKGS is a joint scheme offered by HM Treasury and the IPA aimed at supporting private investment into UK infrastructure projects. The scheme guarantees the principal loan and interest payments on debt issued to the infrastructure project. Guarantees are awarded by infrastructure finance specialists at the IPA.[64] The UKGS can issue up to a total of £40 billion in guarantees.

72. The UKGS could be scaled up to replace the role of the EIB in the UK infrastructure market. Specifically, a strengthened version of the UKGS could be developed to offer guarantees for projects during the construction period, in which most risk is encountered. As the

[63] J. Comte, 'EIB proposes new subsidiary for lending outside the EU', *Global Capital*, 5 December 2017, [online] Available at: http://www.globalcapital.com/article/b15xdbq3nqkvzj/eib-proposes-new-subsidiary-for-lending-outside-the-eu (accessed 6/12/17).
[64] Infrastructure and Projects Authority and HM Treasury, *UK Guarantees Scheme*, 24 August 2017, [online] Available at: https://www.gov.uk/guidance/uk-guarantees-scheme#how-the-scheme-works (accessed 19/12/17).

scheme already exists, this would be particularly useful to minimise disruption by guaranteeing commercial lending.

73. Under the *Infrastructure (Financial Assistance) Act 2012*, HM Treasury can provide financial assistance to any person for the provision of infrastructure.[65] The UKGS, as a scheme jointly run by HM Treasury, could provide *loans* to infrastructure projects on this basis.

74. Section 2 of the Act provides that expenditure and liabilities under the Act may not exceed £50 billion, unless changed by secondary legislation.[66] A combination of guarantee and lending powers could make UKGS a particularly useful replacement for EIB lending. This extension facility has not yet been used.

75. Some participants added that they thought the procedures of the UKGS Scheme were onerous with a low success rate. Users of the EIB also found procedures onerous.

76. It is a widely held belief that HM Treasury only uses the UKGS for large projects and as a last resort. A different philosophy and scale would need to be adopted if the scheme were to be a suitable replacement for EIB lending. Wide scale uptake of guarantees would need to be viewed positively.

77. A transformed UKGS, actively seeking guarantee and loan opportunities, could benefit from emulating EIB approaches.

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[65] Infrastructure (Financial Assistance) Act, HL Bill 43, 55/2. 1.2.
[66] Ibid., 2.

Public Works Loan Board

78. The PWLB is a statutory body, part of the Debt Management Office, which is in turn an executive agency of HM Treasury.[67] It could form a domestic alternative to the EIB in the UK infrastructure market.

79. The PWLB issues Government loans to Local Authorities and other similar bodies from the National Loans Fund. Its funds are limited as outlined: "Section 4 (1) of the National Loans Act 1968 limits the aggregate amount that may be outstanding in respect of commitments entered into by the Public Works Loan Commissioners. The Local Loans (Increase of Limit) Order 2008 increased that limit from £55 billion to £70 billion. Section 300 of the Finance Act 2014 (which requires authorisation by HM Treasury to come into force), allows a further increase of the limit up to £95 billion (principal) on the total of loans outstanding to the PWLB at any one time."[68]

80. Extending the mandate of the PWLB to allow it to issue loans to domestic infrastructure projects would offer funds with similar social benefit considerations that could continue to operate during economic downturns. This would also be less disruptive than creating an entirely new institution.

81. Dependent on terms yet to be reached under the Brexit agreement, current Eurostat guidance would mean that infrastructure projects funded by the PWLB could be placed on balance sheet.[69] Projects would automatically be subject to on balance sheet treatment if

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[67] UK Debt Management Office, *Public Works Loan Board: About the PWLB*, 2017, [online] Available at: http://dmo.gov.uk/responsibilities/local-authority-lending-pwlb/ (accessed 19/12/17).
[68] HM Treasury, *National Loans Fund Account 2016-17*, July 2017, p.6, [online] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/628882/NLF_Annual_Account_2016-17_WEB.pdf (accessed 3/1/18).
[69] European PPP Expertise Centre and Eurostat, *A Guide to the Statistical Treatment of PPPs*, September 2016, p.131, [online] Available at: http://ec.europa.eu/eurostat/documents/1015035/7204121/epec-eurostat-statistical-guide-en.pdf (accessed 5/1/18).

PWLB money constituted more than 50% of the total funding, and subject to statistical consideration of varying degrees if funding from the PWLB exceeded 10%.[70]

Extended British Business Bank

82. The British Business Bank [BBB] is 100% government owned but independently run. It provides funding to smaller business but does not offer funding directly, rather through over 90 partners, which are typically investment funds, banks and venture capitalists. For example, Barclays, M&G Investments and Catapult Ventures are all listed partners.[71] It aims to increase the supply of finance, diversify the market, build confidence and develop a more robust risk management framework to support small businesses.[72]

83. In his 2017 Mansion House Speech, Chancellor Philip Hammond announced greater investment powers for the BBB to counter the loss of funding from the EIB: limits on amounts that the BBB could invest in venture capital funds were raised from 33% to 50%; some of the £400 million in additional funding announced in the Autumn Statement was brought forward.[73]

84. It should be noted that the Green Investment Bank [GIB] was set up in 2012 by the government to promote investment in green infrastructure.[74] Specifically, a report prepared for The Department for Business, Innovation & Skills outlines its role is "to

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[70] European PPP Expertise Centre and Eurostat, *A Guide to the Statistical Treatment of PPPs*, September 2016, p.131.
[71] British Business Bank, *Partners and Programmes*, 2015.
[72] British Business Bank, *What We Do*, 2015, [online] Available at: https://british-business-bank.co.uk/what-the-british-business-bank-does/ (accessed 12/10/17).
[73] HM Treasury and The Rt Hon Philip Hammond MP, 'Mansion House 2017: Speech by the Chancellor of the Exchequer', 20 June 2017.
[74] House of Commons Environmental Audit Committee, *The Future of the Green Investment Bank*, 19 December 2015, London: House of Commons, p.4, [online] Available at: https://publications.parliament.uk/pa/cm201516/cmselect/cmenvaud/536/536.pdf (accessed 13/10/17).

address market failures which prevent capital being deployed as necessary to meet priority environmental policy objectives."[75]

85. The Bank invests on a commercial basis and projects must conform to one of the five green purposes set out by the Enterprise and Regulatory Reform Act 2013:[76]

1. reduce greenhouse gas emissions
2. advance efficiency in the use of natural resources
3. protect of enhance the natural environment
4. protect or enhance biodiversity
5. promote environmental sustainability

86. Since 2012, the GIB has invested £2.3 billion of public money in 60 projects, with a total value of over £10 billion.[77] There are numerous benefits to its involvement in the UK infrastructure market, among which include: acting "as a pioneer lender"; mobilising capital for projects by reassuring investors; providing strategic coordination between lenders; offering long-term loans; helping to "stimulate competition among capital providers by making information more accessible".[78]

87. The Bank was sold in August 2017 to Australian financial group, Macquarie Bank, for £2.3billion,[79] and it now operates under the name Green Investment Group.

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[75] Vivid Economics in association with McKinsey & Co, *The economics of the Green Investment Bank: costs and benefits, rationale and value for money*, report prepared for The Department for Business, Innovation & Skills, October 2011, p.209, [online] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31741/12-554-economics-of-the-green-investment-bank.pdf (accessed 13/10/17).
[76] Enterprise and Regulatory Reform Act, Part 1, [Bill 24, 2013].
[77] Vivid Economics in association with McKinsey & Co, *The economics of the Green Investment Bank: costs and benefits, rationale and value for money*, report prepared for The Department for Business, Innovation & Skills, October 2011, p.209.
[78] Ibid.
[79] *A. Ward, 'Macquarie completes £2.3bn Green Investment Bank deal', The Financial Times, 18th August 2017, [online] Available at: https://www.ft.com/content/e018d83a-835f-11e7-a4ce-15b2513cb3ff (accessed 26/9/17).*

88. Based on the record of the UK's existing domestic interventions in the infrastructure market – the BBB and GIB, now in the private sector – there may be scope to use such concepts to replace some EIB financing.

British Investment Bank

89. A further option proposed to remedy the void created in the domestic infrastructure market by the UK's departure from the EIB is for the UK to set up its own replacement bank.[80]

90. In 2017, the Labour Party set out plans for 'A National Investment Bank for Britain'.[81] The initiative would create both a National Investment Bank [NIB] and Regional Investment Banks which could provide loans collectively of up to £500 billion.[82] This investment would supplement, not replace public spending commitments.[83]

91. Labour proposed the NIB should initially be funded through a £20 billion government bond issue. There would then be subsequent annual bond issues, guaranteed by the UK Government, to increase the balance sheet over a 10-year period to £250 billion.[84]

92. By way of comparison, the EIB funds its loan activities exclusively on the capital market following the initial capital from member states.

93. Given current low-interest rates, Labour proposes that the Government bonds required to setup and then run the NIB could be issued at low yields, with such savings able to be passed on to borrowers.[85]

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80 NB: This could be subject to State Aid rules.
81 See: Labour, *A National Investment Bank for Britain: Putting dynamism into our industrial strategy*, 2017, [online] Available at: http://labour.org.uk/wp-content/uploads/2017/10/National-Investment-Bank-Plans-Report.pdf (accessed 3/1/18).
82 Ibid., p.5.
83 Ibid.
84 Ibid., p.7.
85 Labour, *A National Investment Bank for Britain: Putting dynamism into our industrial strategy*, 2017, p.11.

94. Further, issuing long-term, 10-year bonds would offer stability to the NIB and its borrowers, reducing liquidity risk from frequent needs to refinance.

95. The Scottish Government announced plans to create a Scottish National Investment Bank [SNIB] on Tuesday 5 September 2017 in its Programme for Government 17-18. The intended purpose of the Bank is “to support infrastructure investment (including knowledge, research and development and digital infrastructure), to help companies to grow and to promote our wider economic vision underpinned by Scotland’s Economic Strategy.”[86] Benny Higgins, CEO of Tesco Bank, has been appointed to lead work on an implementation plan due to be completed in February 2018.[87]

96. The Nordic Investment Bank could provide a model which a BIB could follow. It was set up in 1975 by Sweden, Norway, Denmark, Iceland and Finland, later joined by Estonia, Latvia and Lithuania in 2005.[88] It aims to promote a prosperous and sustainable Nordic-Baltic region.[89] It offers both project specific loans and guarantees with most if not all of the ‘soft’ benefits offered by the EIB.[90]

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[86] The Scottish Government, *Consultation on the Scottish National Investment Bank*, 20 October 2017, [online] Available at: http://www.gov.scot/Publications/2017/10/9735 (accessed 8/12/17).
[87] The Scottish Government, *Scottish National Investment Bank implementation plan: terms of reference,* 5 September 2017, [online] Available at: https://beta.gov.scot/publications/national-investment-bank-implementation-plan-terms-of-reference/ (accessed 8/12/17).
[88] R. Skidelsky, F. Martin and C.W. Wigstrom, ‘Blueprint for a British Investment Bank’, *Centre for Global Studies*, 2011, p.12, [online] Available at: http://globalstudies.org.uk/wp-content/uploads/2013/01/Blueprint-for-a-British-Investment-Bank-ebook1.pdf (accessed 20/12/17).
[89] Nordic Investment Bank, *Vision & Mission*, 2017, [online] Available at: https://www.nib.int/about_nib/vision_mission (accessed 20/12/17).
[90] Nordic Investment Bank, *Loan Characteristics*, 2017, [online] Available at: https://www.nib.int/loans/loan_characteristics (accessed 20/12/17).

97. In 2016 the Nordic Investment Bank signed 58 loans and 8 green bonds with a combined value of €4.36 billion.[91]

98. A BIB could similarly fill the role of the 'soft' benefits currently provided by the EIB. For instance, the role of the EIB as a cornerstone investor, fostering confidence for investors, facilitates projects that may not otherwise achieve sufficient funding.

99. A potential difficulty with a BIB as outlined is that it would be a domestic rather than supranational lender subject to political disagreement both concerning its structure and role, and potentially to its lending decisions.

5. NO RELATIONSHIP WITH THE EIB OR IMPLEMENTATION OF A UK REPLACEMENT SOLUTION

100. The final scenario for the UK infrastructure market post-Brexit would involve no ongoing relationship being established with the EIB nor any UK solution to fill the void it would leave. Therefore, the role of the EIB in the UK infrastructure market would come to an end and would not be replaced by a UK institution.

101. Some industry respondents did not think this would be hugely detrimental, but would chiefly result in an increased cost of capital. The liquidity gap left in the UK infrastructure market could, in the majority of cases, be filled by private investors; however, for smaller companies that did not have an agency credit rating or for those that needed financing for innovative projects, it could be significantly problematic.

102. In a large number of cases, the EIB has provided 50% of the senior debt on existing deals. The private sector is currently under increased pressure to refinance the commercial

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[91] Nordic Investment Bank, *Financial Report:2016*, 2016, p.1, [online] Available at: https://www.nib.int/filebank/a/1489500480/837ef08e17542ce50649c98f4e32fafd/6304-NIB_FinancialReport_2016.pdf (accessed 20/12/17).

tranche of deals, but it remains unclear if the EIB will remain after refinancing has taken place. If EIB withdraws financing in this situation, the cost of finance will increase significantly or even destabilise projects.

103. If therefore the UK infrastructure sector is not to be impacted negatively a clear decision on its future financing will be necessary in good time ahead of the UK ceasing to be a member of the EU.

104. When interviewing users and potential users of EIB loans, we asked 'On a scale of 1 to 10, where 1 means no impact and 10 means a detrimental impact, what do you think the impact on the UK infrastructure market would be if the EIB no longer issued loans to UK projects?'. Most respondents thought the level of impact the EIB would be around '4' – disruptive but not catastrophic to UK infrastructure. No respondents answered either '1 or 2' or '8 to 10' suggesting that the impact of the EIB no longer issuing loans to UK projects would not be insignificant, but finance could be sought from the private sector with relatively little disruption to projects on the whole.

105. The EIB in return for Britain's called up capital stake of €3.5 billion has delivered over €177 billion of lending to UK water, energy and other infrastructure as well as social housing projects and innovative technology since 1973.[92]

106. This finance has been available, because of the EIB's sovereign status, at below market rates.

107. It is clear from detailed enquiries that some EIB lending, in particular to utility businesses, would be relatively straightforward to replace currently in the commercial market, but at an increased cost. Estimated increases on the cost of capital without EIB lending ranged from 50 to 100 basis points higher from industry users of EIB loans.

108. Some of those responsible for social, environmental and housing projects however believed that it would be much more difficult to replace EIB finance in these areas. They

[92] European Investment Bank, *Project Loans*, 2017.

welcomed the availability of funding, specifically directed to these purposes, lent by experienced and supportive teams.

109. It also became clear that whilst the removal of EIB lending to the UK would be a significant rather than a catastrophic event in current market conditions, were there to be a major economic downturn or financial crisis, then the EIB's ability to lend because of its sovereign status could become invaluable.

110. The EIB has demonstrated the ability to punch above its weight by acting as a cornerstone investor on major UK projects. In vital infrastructure developments such as Thames Tideway the EIB's presence and its reputation for thorough and effective due diligence serves to reassure other investors.

111. Additionally, the EIB's international credibility and authority has a particular influence on foreign investment and its seal of approval helps the UK increase the proportion of flexible global capital coming to its shores.

112. For all these reasons it would be on balance attractive for the UK to remain a full member of the EIB with a presence on its board, a stake in its capital and the ability to play a full part in shaping its future policies; and by this status continuing to receive a disproportionate share of EIB lending. To achieve this outcome would require a change in the EIB statutes.

113. If for whatever reason it is not possible to negotiate such a treaty change the Government could explore a number of other options.

114. The proposal that Britain become an EFTA/EEA member state would remove problems of conditionality currently stalling EIB loans to the UK. The UK would be subject to the same

obligations as members of the EU,[93] so the EIB could continue to lend to UK projects on the same contractual basis as it does at present.

115. Negotiating a third-country framework agreement with the EIB, similar to the Cotonou Agreement,[94] would enable the EIB to engage in activities in UK without formal membership.

116. One of the options set out about above seems to offer the most promising way of maintaining a connection which has served the UK well. It would be disappointing if this search proved unavailing and it proved necessary to fall back on the arrangements agreed in the 'Joint Report from The Negotiators of The European Union And The United Kingdom Government', whereby Britain's capital stake would be repaid over a 12 year period and its obligation to respond to any limited calls restricted "paripassu" to its remaining stake.[95]

117. This arrangement would have the additional disadvantage that it would not entitle the UK to payment of its share of the reserves which the EIB has accumulated during its life, an amount which could equal €10.6 billion.[96]

118. Of the domestic possibilities to replace EIB lending we believe that it would be best to build on existing institutions, because of their familiarity to markets, their ability to increase lending relatively quickly, with continuity and relatively low transition cost.

119. One potential option would be to see a significant expansion of the UKGS. This scheme has a proven track record but on a more limited scale than was envisaged for it at the time of its foundation. It has tended to be seen by HM Treasury as a means of providing guarantees of last resort where important national schemes would not otherwise be able

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[93] See: EFTA, *EEA Agreement*, 2017.
[94] See: European Commission, *The Cotonou Agreement*, 22 June 2010.
[95] See: Negotiators of the European Union and the United Kingdom of Great Britain and Northern Ireland, *Joint Report from The Negotiators of The European Union and The United Kingdom Government on Progress During Phase 1 Of Negotiations Under Article 50 TEU on the United Kingdom's Orderly Withdrawal from The European Union*, 8 December 2017.
[96] NB: Amount calculated based on the EIB's reserves in 2016 multiplied by the UK's percentage value stake in the EIB.

to proceed. Our understanding is that only 9 guarantees have been issued, constituting £1.8 billion out of a total of £40 billion it could issue.[97] It would be desirable to review the operational procedures and to streamline decision taking under the UKGS if it were to take on this important additional role.

120. Furthermore, HM Treasury could utilise its powers awarded in the *Infrastructure (Financial Assistance) Act 2012,*[98] to provide loans to infrastructure projects through the UKGS. Such a combination of guarantee and lending powers could make UKGS a particularly useful replacement for EIB lending, somewhat similar to the EIB's Project Bond Initiative.

121. Another alternative would be to examine the suitability for expansion of the PWLB. It currently lends to town and parish councils (in England) and town and community councils (in Wales), and major local authorities.[99] Residual maturity – loans outstanding – for 2017 was £110 billion.[100]

122. Again, its procedures would need to be examined to assess their robustness to take on a significantly expanded roll, especially in terms of its ability to carry out due diligence on projects.

123. A BIB, as a new institution, could replicate the EIB more accurately; however, this has been considered on various occasions over the decades with some well-known downsides. One is the perceived risk that the entity turns into a body prone to excessively centralised attempts to plan and direct the economy. There is the problem of perceived political control of such a bank which may deter borrowers and co-investors. The EIB has been free

[97] Infrastructure and Projects Authority and HM Treasury, *UK Guarantees Scheme*, 24 August 2017.
[98] Infrastructure (Financial Assistance) Act, HL Bill 43, 55/2. 1.2.
[99] UK Debt Management Office, *Public Works Loan Board: About the PWLB*, 2017.
[100] UK Debt Management Office, *Public Works Loan: Year End Data*, 2017, [online] Available at: http://www.dmo.gov.uk/media/14995/2017residual.csv (accessed 14/12/17).

from these concerns because of its supranational status and its place as an institution of the EU.

124. The lack of a track record of such a new institution would also do little to reassure foreign investors with its presence on deals.

125. Even without these difficulties there is uncertainty about the likelihood of long-term commitment to such a bank. The GIB, for example, which many saw as the prototype of such an institution with environmental and social dimensions to its work, lasted less than 5 years as a government entity before it was sold to the private sector.

126. The BBB has a limited role, as it does not offer funding directly, rather through over 90 partners, including investment funds, banks and venture capitalists. It focusses on providing funding to smaller business.

127. Its powers have been increased since the EU referendum, with the Chancellor increasing limits on amounts that the British Business Bank could invest in venture capital funds from 33% to 50% and some of the £400 million in additional funding announced in the Autumn Statement was brought forward.[101]

128. These considerations together with the risk of discontinuity and funding gaps while such institutions are established or expanded makes us less persuaded of the merits of this approach.

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[101] HM Treasury and The Rt Hon Philip Hammond MP, *Mansion House 2017: Speech by the Chancellor of the Exchequer*, 20 June 2017.

EVALUATION OF OPTIONS FOR THE UK'S FUTURE RELATIONSHIP WITH THE EIB

	Remain a Member of EIB	EFTA/ EEA	Third Country Agreement	Extend UK Guarantee Scheme	British Business Bank	PWLB/ DMO	British Investment Bank
Subsidised Lending							
Longer Tenors							
New Technologies							
Support Across Economic Cycles							
Cornerstone Investor							
Reassurance to Foreign Investors							
Due Diligence Comfort							

Key

Can Offer

Possible

Not Available

Table 1

ANNEX 1[102]

EFSI Signed projects					
Title	**Country**	**EFSI financing**	**Total investment related to EFSI**	**Sector**	**Approval date**
Rock Rail East Anglia	United Kingdom	69 m	856 m	Transport	09/23/2016
Calvin Smartmeter Roll-out	United Kingdom	48 m (1st tranche)	2115 m	Energy	05/19/2016
Automotive Steel RDI	France	160 m	330 m	RDI	05/19/2016
	Germany				
	Spain				
	Sweden				
	United Kingdom				
Infracapital Greenfield Infrastructure Fund	Belgium	118 m (1st tranche)	Not disclosed	Digital	05/19/2016
	Finland			Energy	
	Germany			Transport	
	Italy			Environment and resource efficiency	
	Poland			Social infrastructure	
	Slovakia				
	Sweden				
	United Kingdom				
Malin Corporation - Life Sciences Investments	Ireland	70 m	1425 m	Smaller companies	06/16/2016
	United Kingdom			Social infrastructure	

[102] European Investment Bank, *EFSI Project List*, 2017.

				RDI	
CUBE Infrastructure Fund II	Czech Republic	100 m	Not disclosed	Digital	06/16/2016
	France			Energy	
	Ireland			Transport	
	Italy			Environment and resource efficiency	
	Sweden				
	United Kingdom				
Technicolor RDI	Belgium	90 m	179 m	RDI	11/15/2016
	France				
	United Kingdom				
Treves Acoustic Product & Systems RDI	France	35 m	89 m	RDI	10/12/2016
	Germany				
	Spain				
	United Kingdom				
QUAERO European Infrastructure Fund	Belgium	40 m	Not disclosed	Digital	03/10/2016
	Finland			Energy	
	France			Transport	
	Germany			Environment and resource efficiency	
	Lithuania			Social infrastructure	
	Spain				
	United Kingdom				
Galloper Offshore Wind	United Kingdom	314 m	1556 m	Energy	09/22/2015
		148 m	435 m	Social infrastructure	09/22/2015

Midland Metropolitan Hospital PPP	United Kingdom			RDI	
Beatrice Offshore	United Kingdom	292 m (1st tranche)	2466 m	Energy	10/21/2015
Smart meters - Project Spark	United Kingdom	478 m (1st tranche)	1378 m	Energy	07/21/2015
Copenhagen Infrastructure II	Germany Poland Sweden United Kingdom	75 m	1275 m	Energy	05/19/2015

ANNEX 2

1. The Infrastructure Forum undertook a series of interviews with users and potential users of EIB finance to comprehensively evaluate the EIB's role in the UK infrastructure market. The following constitutes a summary of those interviews and does not represent the views of the Working Group.

<u>Loan Costs</u>

2. The EIB has provided finance to the UK infrastructure market at cheaper rates than commercial banks. We were told that this could be 50 to 100 basis points lower than the rates of commercial lenders. If such a credit line was no longer available and UK projects had to seek funding from commercial banks or pension funds, this could lead to a £50m annual increase in interest payment costs for the water sector we were told. This would amount to £300m during the period from 2019 to 2025. This is based on the sector expecting to receive finance over this period of approximately £4.5bn from the EIB.

3. A company in the social housing sector estimated that obtaining finance from the private sector were EIB funding to be unavailable could cost an extra £1million per year in interest payments on £100 million loan.

4. One water business, however, which had received approval for an EIB loan to be issued in 2017 instead chose to issue its first Green Bond in the UK market. In this case, the borrower had been able to price their bond inside that of EIB finance; the company felt that this may indicate the beginning of a future trend.

5. Although corporate treasury teams would continue to pursue efficient and cost-effective finance options, many respondents felt that the removal of EIB facilities would increase costs, leading eventually to higher customer prices, reduced sources of supply and the removal of a committed lender with a substantial interest in the projects it financed.

Private markets would replace some of these features at a higher cost; in most cases the problem would be manageable rather than disastrous.

6. Many of the participants thought the EIB played an important role in the UK infrastructure market at present, in particular in providing cheap credit. A business in the rail sector suggested that the EIB was able to offer finance at around 30 basis points less than private lenders.

7. For utility companies, such a rise in the cost of capital would eventually have to be passed on to consumers through regulatory processes. The comprehensive regulatory framework in place in the UK would serve to protect essential utilities such as water and power. Regulators have a duty to ensure that these companies can find suitable finance for their function, and this would help to ensure that they remained investable post-Brexit. The implication was that regulators would not impede an increase in costs being passed down to consumers if an increased reliance on commercial lenders increased the cost of capital.

<u>Market Liquidity</u>

8. Another interviewee believed that the gap in credit spreads between the EIB and commercial lenders was reducing. This resulted from greater liquidity in the market, stimulated by the European Central Bank’s implementation of quantitative easing mechanisms.

9. The scale of current EIB lending is significant. During the Control Period from 2019 to 2025 the water sector expects to receive £4.5bn in EIB finance. The capability of commercial banks to meet this need has not yet been tested; some interviewees expressed concern that in any financial downturn or crisis the EIB could provide liquidity unavailable elsewhere.

10. Smaller businesses felt that alternative financing options would not be available to all: smaller enterprises without a strong credit rating may suffer disproportionate difficulty obtaining finance in the absence of EIB.

11. One perspective was that current economic conditions meant that the cost of commercial capital had fallen significantly recently; the infrastructure market did therefore currently have access to low cost finance from sources other than the EIB. It was open to interpretation how long such low interest rates could and would prevail.

12. There is a semi-formal limit on the amount of EIB finance any one company can receive. This ensures the EIB does not expose itself to too much risk from a single organisation but limits its effectiveness, but participants noted this was not unlike any other bank and was good practice.

Crowding Out

13. Whilst EIB facilities may ‘crowd out’ other potential lenders in some circumstances those we consulted tended to the view that this was compensated for by the value of the EIB as a cornerstone investor.

14. For complex and high-risk projects they considered that the presence of EIB finance encourages equity investors and other lenders. The EIB’s thorough due diligence, careful assessment, close enforcement and scale of exposure of the EIB meant that its presence in large projects such as Tideway had a valuable encouraging effect.

15. The availability of such low-cost finance drove private lenders to reduce the cost of borrowing in order to compete. The UK’s exit from the EIB would not however mean that financing would become hard to come by: finance would still be accessible from commercial banks and increasingly, it was thought pension funds, at a somewhat higher rate of interest.

Loan Tenor

16. The EIB is able to provide loans with much longer tenor than the private sector tends to provide. Depending on the credit risk profile and project assets, the EIB can provide loans for typically 15 years, but can extend this to 30 years.[103] This is an important consideration where major national projects are concerned.

17. Such refinancing risk born from short loan maturities is not suitable to be carried by large infrastructure projects, as it can threaten project delivery targets. Therefore, EIB loans with much longer maturities were a valuable resource for the UK infrastructure market.

18. EIB loans, we were also advised, had a unique facility which made it easier for borrowers to draw down approved funds as required over a period rather than in one sum at the start of the project. This offers greater flexibility for company treasury teams when managing the balance sheet. With commercial long-term interest rates currently at approximately 3.2% and short-term interest rates at 0.17%, the cost of having cash and debt on its balance sheet was significant; the capability to drawdown on EIB loans in several tranches was valuable, we were told. *(TIF notes that this comparison refers to EIB finance compared with a commercial bond issue).*

EIB Procedures

19. There is a widespread perception that securing EIB finance is more burdensome, in terms of procedures and documentation, than with commercial banks. Because of its role in supporting the policy objectives of the EU, the EIB requires borrowers to adhere to particular conditions and has a lengthy due diligence process. The EIB is less flexible than its private counterparts. Processes are time consuming. We were told that its procedures are stringent to such an extent that specialist lawyers had to be hired to deal specifically

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[103] European Investment Bank, *Project loans – features*, 2017, [online] Available at: http://www.eib.org/products/sheets/project-loans-features.htm (accessed 6/11/17).

with the EIB loan application. Many respondents noted that these procedures can significantly delay the process.

20. Notwithstanding some interviewees found this burdensome, others felt that identifying the EIB policy priorities, complying with them, and engaging closely with the Bank resulted in a valuable long-term relationship with a high level of EIB engagement.

21. EIB professionalism was considered by some respondents to be a positive reason for applying for seeking EIB loans. The EIB takes considerable time to understand the projects it is investing in, often carrying out several site visits and meetings with the teams involved. It also accounts for the social benefits of a project within the application process. This due diligence also serves to reassure other investors in the project.

22. Some respondents suggested that EIB processes lacked transparency. This made it difficult to understand what was required to get loans approved.

23. One respondent highlighted that the EIB tended to be more pragmatic when it came to compliance with the Equator Principles compared to a number of the European project finance institutions.

Interest Rates

24. Participants noted that the EIB is able to offer both fixed and variable interest rate loans at the discretion of the borrower. This gives greater flexibility to company treasury teams in terms of managing their balance sheet.

25. The capability to fix interest rates on EIB loans can be beneficial for projects, particularly those with international exposure, at times of economic uncertainty. Interest rates could also be forward-fixed offering further stability to projects. This would avoid the need to hedge transactions for future interest rate risk exposure on later draw down of funds, simplifying balance sheet management.

Currencies

26. A business in the transport sector cited the ability to borrow in different currencies as a useful feature of EIB loans. The EIB chiefly issues loans in Euro, Sterling and US Dollars – 44% of loans were issued in Euros in 2016, 12% in Sterling and 37% in US Dollars.[104]

27. The EIB's capability to issue loans in Sterling was important given the limited nature of the UK Sterling bond market. Companies were also able to build long-term relationships with the EIB, which it could not in the bond market – bond holders would change significantly on each issue. Such relationships were especially vital given the scope of the UK's infrastructure pipeline.

Impact on the Industry

28. Participants in the survey were asked for their opinion of the potential severity of impact were the EIB to no longer lend to UK projects after Brexit.

29. EIB finance provided to third countries aims to further EU objectives and the integration of EU countries with their trading partners. The financing of UK utilities is unlikely to be considered in this light if the future relationship of the UK with EIB is as a third country. It makes future EIB attitudes difficult to predict.

30. Many interviewees noted that Brexit negotiations and political uncertainty had led EIB finance to the UK to stall. The EIB has increased its due diligence processes to take into account an uncertain future UK-EU relationship. Large projects in particular may find it difficult to refinance in the future against this background.

31. One interviewee suggested that market opinions thought the EIB may also be evaluating changes to covenants and other terms on UK loan contracts to protect itself were the UK indeed to cease to be a shareholder in the EIB.

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[104] European Investment Bank, *Financial Report*, 2016, p.13.

32. There are also sectoral anxieties: one interviewee in the Rail sector suggested that the EIB had changed its policy and would no longer support rolling stock projects.

Alternatives

36. Those questioned had differing views as to the necessity for and likely prospects of a British alternative domestic approach dedicated to the financing of infrastructure and related projects.

37. One water sector business, having had experience of obtaining EIB finance and also issuing bonds to market, thought that appropriately designed bonds could have a role in promoting sustainable investment. Therefore, the social benefits considered by EIB due diligence processes could be replicated by private lenders. Although the larger companies would have a credit rating sufficient to make bond issuance of this nature a viable alternative, it would not be available to all. Thus, smaller companies and sectors where finance was not easily obtainable from the private sector might need government intervention in the market, specifically where there was a genuine risk of market failure.

38. A British Investment Bank has frequently been mentioned as a possible way forward. Those we interviewed had a number of different perspective on the issues which it would raise. Few believed that it would be quick or straightforward to set up such a lender.

39. In some regulated markets lending from such a body could become politicised and loan decisions subject to lobbying and other pressures. As a supranational body, the EIB is able to maintain a degree of impartiality that upholds its credibility as a lender.

40. Some felt that a domestic institution could be a helpful way to ‘bridge the gap’ in the UK infrastructure finance market during any extended negotiating or transitional period. It might offer shorter lines of communication and more streamlined procedures.

41. Previous UK government interventions in the private sector had failed to deliver finance on the scale needed. Both the British Business Bank and Green Investment Bank had limited

roles; the GIB had now been sold to the private sector. One respondent also thought it was unlikely that a UK institution might be able to offer the same low cost of capital as the EIB losing one of its most significant benefits.

42. Many participants, particularly those from larger companies, thought the creation of a British Investment Bank was not necessary to replace the role of the EIB, as there was significant liquidity in capital markets. In particular, pension funds were cited as a large, relatively untapped source of capital for infrastructure projects. The long-term investment needs of such potential lenders match those of large scale infrastructure projects; but appropriate vehicles would need to be created to access such funding. Large institutions had the ability to create such vehicles although there was some disappointment at the speed of progress to date.

43. It was suggested that in the future investors may invest directly in projects, rather than broad-based funds. This could be reflected in new vehicles designed to funnel pension liquidity directly into infrastructure projects. More extensive methods of information gathering would need to be allowed and developed by projects to satisfy investor demands.

44. Some respondents suggested that the UK Guarantees Scheme might play a part in replacing the role of the EIB in the UK infrastructure market. It was suggested that the UKGS could be scaled up to fill gaps left by the EIB and minimise disruption during the transition period by guaranteeing commercial lending. Conversely, some participants thought the operation of the scheme was notoriously 'clunky'. The UK Guarantee Schemes is not held in the same regard as the EIB in terms of due diligence process, and does not provide comfort for private investors to the same degree. Further, the deadlines and templates involved were onerous.

45. It was suggested that a strengthened version of the UK Guarantees Scheme could be developed to offer limited guarantees for projects during the construction period, in which most risk is encountered.

46. Some participants had suggested that private lenders were not comforted by HMT's presence on deals during the financial crisis, but were by the EIB's such presence. One participant added that this had not been the main purpose of the UK Guarantees Scheme. In other cases, the EIB proved more of a hindrance than help, for example on the M25 upgrade deal where investors had several calls on equity, whereas other, smaller projects had none.

47. It was suggested that the Public Works Loan Board (PWLB), part of the Debt Management Office (DMO), may provide another alternative to the EIB in the UK infrastructure market. It issues loans to Local Authorities and other similar bodies from the National Loans Fund, and currently operates under the policy framework of HM Treasury. Project approvals must be first obtained from the Department for Communities and Local Government, as well as the Department for Environment, Food and Rural Affairs.[105] This offers some of the social benefit sympathies and due diligence processes as the EIB, serving to reassure other private investors. Consequently, it may prove useful to extend the operation of the PWLB or create a similar institution specifically for infrastructure projects within the DMO.

[105] UK Debt Management Office, *Public Works Loan Board About the PWLB*, 2017.

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