Excellence in Place Leadership Programme

Session 2:
Making Green Finance Work

March 2020. KPMG, London

Answering the problem:

"The Government published its Green Finance Strategy: transforming finance for a greener future, in July 2019. What does this practically mean for Place Leaders and what must we do differently in our day job to embed this strategy?"

The UK Green Finance strategy – background and government policy context

In mid-2019 the UK government took a bold step designed to accelerate action to tackle the climate emergency by committing to legally binding targets that will bring the nation's greenhouse gas emissions to net zero by 2050.

Driven in part by pre-Brexit political ambition to lead Europe and the world with game-changing green policies and investment in new and existing low carbon technologies, the resulting challenge has left both the public and private sector with a major investment predicament, but also potential opportunity.

The government's recently published UK Green Finance Strategy highlights this ambition. The UK's hosting of the November 2020 COP26 global climate action conference in Glasgow gives the delivery challenge extra impetus, as does the appointment of out-going Bank of England boss Mark Carney as Finance Adviser to the UK government, underlining the key role that finance will play in meeting these stretching goals.

The scale of this expected investment is huge. Some £35-£65bn is thought to be required to deliver nationwide low carbon energy transition; some £70bn to deliver a low carbon mobility revolution. Mobilising private investment will be key to meeting our low carbon targets.

The Green Deal was an attempt in the early 2000s by central government to persuade the public and local authorities to invest in efficient low carbon energy solutions. However, it was not an attractive proposition and failed to deliver the hoped-for energy transformation across the UK. The latest Green Finance Strategy interventions must learn from this experience and be more market aligned.

The good news today is that there is no shortage of available funds for long term investment in infrastructure. In addition, "green investment" is now hard wired into the Environmental, Social and Governance (ESG) principles of the majority of funders' investment criteria. The challenge across the public and private sector is understanding what is meant by "green" and how to meet these ESG goals, particularly when local authorities plan public projects.

"We spend hundreds of millions of pounds but we really have no green commissioning plan. What is needed is a market positioning statement that tells the market where, when and in what local authorities will be commissioning."

Neil Gibson, past President ADEPT

"To meet the UK's net zero carbon targets by 2050 we need to crack on now at pace."

Ben Foulser, Partner, KPMG

Environmental, Social and Governance principles

- *Environmental, Social, and Governance (ESG) are three key factors used by the finance sector to measure the sustainability and societal impact of investments.*
- *ESG now commonly embedded into investment process, driven by need from corporates and investors to assess impact of investments. Europe leads the way – with the USA and Asia slow to catch-up.*
- *ESG policies can include exclusions (eg coal) or require specific asset assessment to be made when assembling investment deals. Carbon reporting is increasingly common. However, there is no single mechanism to measure ESG which tends to be qualitative assessment rather than quantitative.*
- *Institutional investors tend to lead the way and it is expected that they will increasingly challenge future investments in carbon industries going forwards.*

"The green finance strategy highlights an opportunity to differentiate UK post-Brexit. The challenge is how do we actually enable industry to come behind this green initiative."

Alasdair Grainger, Deputy Director, BEIS

How does local government embrace this low carbon opportunity?

Clearly the Green Finance Strategy is the product of the last government. However, while the headlines of "Greening Finance", "Financing Green" and "Capturing the Opportunity" outlined in the strategy may change, the fundamental need to embrace green finance remains.

Green finance brings together two areas of UK strength: climate policy and financial services. It is now likely to sit alongside the new Government's priorities investing in "place" and "levelling up" as a means to drive forward a new regional equality across the UK.

Infrastructure investment is now increasingly aimed at enabling communities to thrive. Where previously lip service was given to such green initiatives, we are now seeing ESG and the demand to meet Sustainable Development Goals really embedded in the market, with investment businesses really taking a role to find projects with measurable social impact.

As Local Authorities start to adopt policies that drive low carbon outcomes - particularly as the number declaring a climate emergency increases – the opportunity to embrace a new net-zero environment increases with potentially huge social outcomes. But there are financing gaps – gaps which green finance should be able to fill provided the public sector understands how best to embrace it.

Understanding the Green Finance market

Identifying the tangible social outcomes from investments is key to delivering projects that attract green finance, allowing access to a wider pool of money and at different, better returns from targeted green funds. That means embedding measurable outcomes in the procurement and delivery process to boost access to the market and understanding the different impacts on capital versus revenue funding.

But it also means getting the policies right and ensuring that they will not be subject to change at the first political whim.

Failure by a local authority to really understand how the market and the particular activity or industry being invested in works can see deals rapidly fall apart and leave private investors with stranded, irrecoverable assets, reaching for lawyers and no desire to enter that market again.

On the other hand, a proper understanding of the risks and rewards on both sides of a deal can actually prompt unimagined positive outcomes. Such as, the creation of a new social fund that benefits the community by collecting the upside and downside from marginal changes seen in a deal.

Understanding the difference between financing and funding is crucial. As with all investments, the market will, of course, look carefully at the risks involved, at the impact of that investment and at the potential for the asset to become stranded by political interference, or through any other issue that impacts the ability of the project to be funded and delivered.

As such, the private finance market – green or otherwise – does not say yes to everything. For example, in the power, utilities and digital markets it is more likely the public sector will fund the deal so the commercial model is harder to stack up. But in areas such as mobility or sectors where the technology doesn't exist for net zero, the private sector is key.

To identify where local authorities can maximise the benefits of green finance, a granular, bottom up analysis of what is needed and by when is crucial. This can then be combined with the mix of central government policy, commercial incentives and direct financing to achieve the plan plus engagement with the private sector and with communities to decide where investment is required.

"There is a lot of financing available for investment. The key issue is who is going to pay – and the funding only comes from users or taxation. Usually problems are not from financing but from funding."

Darryl Murphy, Head of Infrastructure Debt, Aviva Investors

"Banks won't fund woolly. Continuity is really important. We need to have policies that survive new administrations; to set standards that help private sector to tick boxes for sustainable financing".

Graham Smith, HSBC

Key issues for local authorities to consider

- *Building partnerships with the private sector – overcoming reluctance to engage due to past poorly performing models.*
- *Creating effective communication with politicians – persuading elected leaders to adopt new policies is critical to embracing.*
- *Managing risk – not taking action will see the risk of climate change impacts such as flooding and physical asset damage; taking action introduces new risks from the transition to a new low carbon economy.*
- *Policy interventions are key to driving investment – and ensuring that they are not subject to politically motivated change.*
- *Establishing a joined up plan for "place" - understanding the social economic crossover of investment decisions.*
- *How best to work to encourage government leadership to provide speedy mandate for change.*
- *Can local authorities work together to make a collective difference – increasing the scale of developments can improve the attractiveness of investment opportunity.*
- *Urban solutions can differ from rural – simply customising a green urban investment solution for the rural setting may not delivery the desired outcomes.*

Where are the gaps – what stops local authorities embracing green finance?

- *Lack of knowledge and ability to think like the lender.*
- *Local authority policy isn't up to date with the wider climate emergency strategy.*
- *Insufficient stability and standardisation around decision making and procurement processes.*
- *Poor internal communication and training around project finance.*
- *Benchmarking data and ability to learn from other peers isn't there.*
- *Lack of appetite for risk and handing public assets to the private sector.*
- *Lack of cash to pump prime projects.*
- *Public sector borrowing routes are cheaper than using private finance.*
- *The public sector is driven to reduce borrowing.*

> *"Sometimes it's not the financing but policy that holds us back."*
>
> **Andrew Cardwell, Director, Amey**

Points for further discussion

- *Local authorities have the ability to use the net zero agenda to tell a positive local story and engage communities with the benefits of investment in place. They can be the agents for change – so what is stopping them?*
- *A focus on innovation and outcome-based solutions can change local authority thinking from a traditional linear, silo-based approach towards a more joined up, systematic delivery which embraces the local context and engages with the private sector. What stops this from happening?*
- *To what extent is central government policy and legislation necessary to drive local change and ensure that the benefits of place-based decisions are realised?*
- *How can local authorities make the case and use financial tools to limit consumption and demand for services rather than simply reducing carbon in delivery?*

Case study - Carbon Disclosure Project

CDP support over 800 cities and local authorities around the world by helping them to measure and monitor their progress towards meeting the net zero carbon target by 2050. By understanding progress and measuring gaps the team works with authorities to put in place strategies, leadership and interventions that use best practice to accelerate change.

Currently CDP works with 179 cities and local authorities across Europe – half of which have less than 500,000 inhabitants. Since 2015, 90% of these have set emission reduction targets and the number of cities with climate action plans has doubled.

In the UK CDP has worked with 19 local authorities to put in place plans to publicise their climate change emergency plans and policies and has actively worked with partners to offer relevant mitigation and adaptation tools and services. By auditing and transparently scoring performance from A to D, the project helps authority officers understand what true climate change leadership looks like, allowing them to learn from, and compare themselves, to global best practice.

"Our programme is about global best practice. It's really about leadership and we understand what it takes to be a leader in carbon reduction."

Simeran Bachra, UK Cities Manager, CDP

The challenge for cities is clear – while 55% of the global population lives in them, they provide 70% of the emissions worldwide. Reduction starts with measurement and there are many tools and organisations available for local authorities to measure their carbon reduction progress:

- *The Tyndall Centre's carbon budget tool*
- *The Anthesis SCATTER tool*
- *Ashden's Climate Action Co-benefits Toolkit*
- *UK100 - local authorities can commit to 100% clean energy by 2050*
- *The Global Covenant of Mayors - a global alliance for city climate leadership*
- *ICLEI Local Governments for Sustainability - a global network of more than 1,750 local and regional governments*
- *C40 - a network of the world's megacities committed to addressing climate change.*

The Matchmaker tool has been set up by CDP to help break down barriers to investment in low carbon projects by grouping similar projects across cities and local authorities by offering scale, density and co-benefits of taking action. Potential investors are then offered larger, bankable cross-region or cross-sector projects.

Update from EiPL #1
Outcome Based Procurement Working Group

This working group was formed after the first EiPL session which highlighted the need for a novel contract form which had real contract documentation that could practically be used by local authorities to drive outcome-based procurement. The goal is to create more flexible and adaptable procurement tools.

A working group has been set up to tackle the issue and consists of representatives from Bird & Bird, GO Lab, Connected Places Catapult, Amey and Ferrovial Services. The group is now seeking funding to undertake research and produce an initial paper that will validate a proof of concept. Interest from the EiPL cohort is sought to help drive the project. Creating a true partnership between private and public sector is vital for success.

The work is likely to include a degree of myth-busting around outcome-based approaches not least proving that it does not have to cost more. That means spending time shaping the story – proving to local authority finance directors and Treasury that this approach will boost efficiency.

"We have got to offer a different way of working – the commercial model is a place to start."

Mark Saunders, Director of the Centre of Excellence for Cities, Ferrovial

Other key issues identified for further discussion:

- *What procurement models will best create partnerships that engage and empower citizens?*
- *What can be done to improve communication and influence with politicians?*
- *How can procurement promote the early involvement of the private sector?*