

Select Committee on the European Union

Financial Affairs Sub-Committee

Oral evidence:

Brexit: the European Investment Bank

Wednesday 17 October 2018

10.05 am

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Members present: Baroness Falkner of Margravine (Chairman); Lord Bruce of Bennachie; Lord Butler of Brockwell; Baroness Liddell of Coatdyke; Earl of Lindsay; Baroness Neville-Rolfe; Lord Vaux of Harrowden.

Evidence Session No. 2

Heard in Public

Questions 20 - 29

Witnesses

I: Pete Clutton-Brock, Policy Adviser, E3G; Alex Conway, Assistant Director, Brexit and European Programmes, Greater London Authority; Philip Harding, Director of Finance and Business Affairs at University College London; Piers Williamson, Chief Executive, The Housing Finance Corporation.

Examination of witnesses

Pete Clutton-Brock, Alex Conway, Philip Harding and Piers Williamson.

Q20 **The Chairman:** Good morning. Welcome to the EU Financial Affairs Sub-Committee's public evidence session. Mr Piers Williamson from The Housing Finance Corporation, Mr Philip Harding from University College London, representing UUK, Mr Alex Conway from the Greater London Authority and Mr Peter Clutton-Brock from E3G, we are delighted to have you here to talk to us. You have before you a declaration of members' interests. This is a public evidence session and it is being broadcast live on parliamentlive.tv. A full transcript is being taken and will be made available to you shortly after the session.

We will start with a general overview from you as to how important the

European Investment Bank is to each of your respective industries. Are there specific projects that you would not have been able to finance, irrespective of the cost of financing, which we realise is a big issue, if the EIB was not available to us? How would those kinds of projects, if you can think of any, be financed without EIB participation?

Piers Williamson: My organisation has been around for 31 years, and we have been dealing with the European Investment Bank for the past 20, so we have quite a long track record. My organisation finances housing associations, which borrow about £80 billion in the private debt market. I calculate that in total EIB lends about £4 billion, so it is only about 5% of the market. Around £2.5 billion of that £4 billion is channelled through our organisation, so that gives you an idea of the scale.

EIB's expertise is primarily, in technical terms, in project finance: financing motorways, sewers and all of those good things. There are not many examples of single large housing regeneration projects. Housing regeneration is often spread very widely, so our role is to act as an aggregator. The EIB likes what we do because we have active contacts. We actively lend to about 160 different organisations around the country, and our skills sit in the middle.

The EIB follows European Community policy goals. I do not think you will find housebuilding as one of those goals. We have been able to finesse housing regeneration over 20 years through focuses on employment, retrofitting, with a lot of energy efficiency work, and regional work. We have done some work in the Creggan estate in Derry, or Londonderry, depending on your religious tastes. We have also done a lot of work in inner-city Glasgow and the south Wales valleys. That is very appealing to the EIB. Post the crunch, when the Juncker plan came out, the EIB was encouraged to do more everywhere, and that is where the bulk of our capacity has been.

I would not say that houses would not be built without the EIB. Its influence is a little more subtle than that. Because it tends to be the lowest cost form of finance, it can be used almost as an accelerant; phases of regeneration that might not happen can be encouraged to happen because, essentially, it provides a revenue subsidy over commercial forms of funding.

We have relatively successfully run an affordable homes guarantee scheme for the Government. The Government thought of it first and foremost as a bond finance vehicle, where we have a lot of expertise, but there are an awful lot of moving parts and risks in building a completely new set of processes with government and MHCLG, so using the European Investment Bank as the front-runner to test the process was vital. We were known quantities to each other. It might have taken us six months or a year longer if we had had to use the bond markets as the vehicle in which we operated. Those are my primary points.

Philip Harding: I am finance director at University College London and can speak about our personal experience of having worked with the European Investment Bank. We secured a loan of £280 million from the EIB two years ago, which is the largest single loan that the European Investment Bank has made to the UK higher education sector.

Universities have been actively working with the European Investment Bank for the last 12 years or so, and only relatively recently has it been a source of funding for projects in higher education. Over that period, universities have borrowed about €2.6 billion from the European Investment Bank, accounting for in excess of 30 projects across 24 universities. Prior to that period, the primary source of debt finance for universities was bank lending, at the time when banks were prepared to lend long term and at attractive rates to universities. That is no longer the case. Typically, bank lending for universities is now limited to much shorter periods of between five and seven years.

The European Investment Bank is important in assisting universities with long-term, large-scale infrastructure investments. In our case, we are using finance we have secured from the European Investment Bank to help us build a new campus for University College London on the former Olympic park in Newham, which is a very large-scale major development project for us.

As to the nature of university investments, particularly large-scale infrastructure investments, universities are charities; they are not-for-profit organisations. Typically, these sorts of projects do not pay back very quickly, nor do they generate particularly attractive financial returns. Often, the benefits are secured over a longer period and are largely intangible or difficult to quantify; they enhance the value that students get from their experience by being able to access high-quality facilities and improve the quality and quantity of research output from universities. The EIB offers one of the few opportunities to secure long-term, attractively priced finance. In our case, the finance was over a 30-year term.

There are alternatives. Recently, a number of universities have secured access to capital markets through long-term, relatively low-cost bond issues. They are not as low cost as the European Investment Bank but there are opportunities. There are difficulties with that finance, in that it tends to be available only to universities that can demonstrate and retain the highest credit rating. It is not generally available to all universities, whereas the European Investment Bank, in its record over the 12 years I have talked about, has invested across the whole range of the sector, not just the higher-rated universities but all of them, and in a variety of projects that not only assist universities in achieving their aims but serve wider needs, assisting economic regeneration in some parts of the country and securing additional employment opportunities, which is very much part of what we are doing in Newham.

Alex Conway: I will answer the question wearing three different hats, if I may. First, from an overall London perspective, the EIB supports a lot of

different kinds of projects in London. You have just heard examples from my colleagues about social housing and universities. There are also things like the Tideway tunnel, our electricity distribution network and improvements in the transport network, so they are important to London overall.

Secondly, my role at the GLA is to advise the mayor on Brexit issues, and to manage EU structural fund programmes where the EIB has been very significant. As you may know, one of the cardinal rules of EU funding programmes is that they must be matched. You can use EIB funding as matched funding. Over the last two programmes, large loan and equity funds have been set up across England and Wales to lend money to small businesses. At least £300 million was matched under the previous 2007-13 programme and more than £400 million in the new programmes, so it is a significant player there.

Thirdly, and I will concentrate on this, it is lending to Transport for London in particular. The EIB has been a very important partner in financing its loans for Crossrail, London Overground and the Tube and Docklands Light Railway extensions.

As Piers and Philip said, the main value is that it is the lowest-cost form of finance. EIB interest rates have consistently been very competitive, resulting in significant savings compared with TfL's other long-term funding options. We can compare and contrast the Public Works Loan Board in particular. TfL has been borrowing from the EIB for over 10 years. Current EIB loans are worth about £3.3 billion, which is around 30% of TfL's direct borrowing. The last scheduled repayment, currently, is in 2052, so it is spread out over a fair time.

In addition to benefiting from direct EIB borrowing, TfL benefits indirectly through its rolling stock leases. EIB has lent to some of its lessors at the same competitive rates that it would have offered TfL directly. That means lower interest rates, lower rentals under the operating leases and lower cost to the taxpayer overall.

Pete Clutton-Brock: My organisation, E3G, works on energy and climate change policy, so that is the purview of my contribution to the Committee as I see it. The energy industry is undergoing a major transition at the moment from a high-carbon intensive industry towards a low-carbon system. That transition is highly capital intensive and requires new assets to be developed. The cost of the capital to fund those assets is a key contribution to the overall cost of transition, so keeping the cost of capital down is key to ensuring that the low-carbon transition is done in a cost-effective way.

There is no shortage of capital in the capital markets to fund energy assets. However, the types of technologies that are being developed often come with a new technology risk for some institutional investors and some mainstream public project finance investors, so the ability of the EIB to take on some of the project risk and technology risk is a major contributing factor. They would not be there without it.

EIB contributed €9.3 billion to the UK energy system between 2012 and 2016, which is a not insignificant amount, but the quantum of finance is not the core factor, as my colleagues have said; it is the fact that the EIB has an AAA rating and is therefore able to borrow relatively cheaply from the capital markets, coupled with the fact that it does not have a mandate requiring it to achieve a commercial return, which allows it to offer slightly cheaper finance than other private institutions. It is able to take slightly different positions on energy projects. It is able to take on what are called junior or mezzanine debt positions that are slightly riskier and less attractive to mainstream investors.

In the energy industry, we have seen a major boost for technologies such as offshore wind, which has matured substantially over the past five to 10 years. That has been due partly to sources such as the EIB and, more recently, the Green Investment Bank, now privatised. They took on some construction risk, which has been really important, and developed innovative projects, such as agglomerating smaller projects that would not have been attractive to large investors. Since 2008, after the financial crisis, credit has been extremely tight, and the ability of the EIB and the GIB to provide countercyclical finance has been a very useful factor.

The Chairman: I want to pick up a point raised by Mr Harding about financing. The Housing Finance Corporation has already mentioned the fact that housing associations raise money through bond issues. You brought that in at the end and said universities were moving in that direction, but could that not be a viable alternative? In light of the fact that EIB funding will not be available in the future, do you see universities taking that particular route?

Philip Harding: Some universities have. About 10 or 12 universities have now accessed the capital markets through either public bond issues or private placements, in response to the fact that traditional bank lending contracted in the way it did. There is no doubt that it is a very valuable source of access to funding, in some cases extremely long-term funding. The University of Oxford issued a 100-year bond, for example, which is the first time that has happened in the UK.

The advantages are that it can be low cost. It is not as low cost as EIB lending, but it is nevertheless low cost. It has some drawbacks, in that you do not get the same degree of flexibility that we have been able to secure with the European Investment Bank. Typically, with a bond issue you get all the cash on day one rather than being able to draw it down in a phased way.

The Chairman: You touched on the quality and quantity of research, which is also written up in your submission. Perhaps I need a few concrete examples in that regard. We did research in the past before EIB funding was available.

Philip Harding: We did.

The Chairman: What did you mean? Did you mean something tangible,

because Horizon 2020 is what funds your research programmes? Are you talking of just physical infrastructure?

Philip Harding: Correct.

The Chairman: New labs.

Philip Harding: Yes. One of the ways we deployed European Investment Bank funding to support research was to co-fund, with the Medical Research Council, the creation of the Dementia Research Institute.

The Chairman: It is the infrastructure, the buildings.

Philip Harding: Yes.

Q21 **Lord Bruce of Bennachie:** You have answered some of the questions, but I would like to probe a bit further. You have all said that because the EIB exists the costs are lower, and that the EIB is less risk averse and is prepared to lend long term. Actually, investment by the EIB in the UK has fallen in the last two or three years, the implication being that that is not because it is not approving things but that we are not looking for the money.

Is that fall likely to continue? Has the need for the EIB diminished, and for how long? Assuming that the EIB is not there, or we do not have access to it, what are the best options for whatever investment will be needed, or at least hoped for?

Piers Williamson: I disagree slightly with your analysis. Our experience of the EIB post the Brexit vote is that the EIB has political masters at the end of the day. While there is uncertainty about the terms of the settlement, or whatever happens post next March, I think it is hesitant to front-run funding.

Lord Bruce of Bennachie: Is there evidence of applications being pushed back or rejected?

Piers Williamson: There was in my market in the early post-vote days. If you have ever negotiated with Japanese banks, you will know that they never say no; they always find other questions to ask you. In practical terms, the EIB is a master of that game, so quite a lot of that has been going on. Life has eased slightly for my market in the last six months. The Wheatley Group, a Glasgow housing association, has closed a deal, but even those deals have some very unusual pre-payment events linked to the nature of Brexit. Borrowers are quite reticent to draw those loans ahead of certainty on Brexit.

The second part of the question was about what happens next. From my business's point of view, we have been dealing with the EIB for the past 20 years and contractually will have to deal with it for the next 30 years, so we know it pretty well. My working assumption is that we will go to the bottom of the priority pile in Europe, because 27 other nations will want first access to the honeypot that is EIB funding. The EIB funds quite a lot outside the European Union, but it does so only with a framework

agreement, which is a political construct, and it is likely to be only with a sovereign guarantee linked to that.

Our working assumption is that for the EIB itself we will be a lower priority. It would be fantastic if that was not the case. People find the housing market people very difficult; there is no silver bullet for producing more investment in housing as a whole. I always work on the nudge theory: lots of little improvements and forms of subsidy, with 20 or 30 different initiatives, are the way to get more housing.

We have the Budget in two weeks' time. There are £8 billion-worth of housing guarantees available. The UK sovereign is not as strong a credit as the European Investment Bank; it is an AA credit and the EIB is AAA, so the borrowing rates of the subsidy will not be as great as with the EIB, but there are very obvious routes to creating a form of subsidy and long-term funding to go with it.

May I make one point about your question on universities and bond finance? We issued £250 million-worth of bonds last month. We have issued several billions of pounds-worth of bonds as well as working with the EIB. One structural point to keep an eye on is that the number of very long-term investors with significant sterling proceeds to invest in infrastructure as a whole is relatively small; there are probably 10 or 20 large investors. With changes in the defined benefit pension scheme, those sources of very long-term funding may gently become more concentrated and the rate of growth will slow, so it is important that there are diverse forms of access to long-term capital for eminently long-term schemes such as universities, the building of tunnels and funding housing. The sterling bond markets are not a bottomless pit.

Pete Clutton-Brock: My understanding of the figures is that EIB financing to the UK fell from €6.9 billion in 2016 to €1.18 billion in 2017, so it is a substantial decline. In the energy sector, some people have tried to attribute that to Brexit and the referendum vote. Our evidence suggests that although that can be the case with manufacturing assets, such as factories to create new wind turbines, it is not so much the case with new generation assets. The financing of new wind farms or other generation assets is defined more by domestic policy; in the case of energy, it is whether or not contract for difference auctions are happening, which they are not.

We expect more contract for difference auctions, and that will create new projects. The fact that we have not had auctions to date has meant that new projects have not been coming forward and hence have not been seeking EIB finance, so the reduction is largely in the UK seeking EIB finance; it is down to domestic policy.

Lord Bruce of Bennachie: If the EIB is not accessible to us, how significant will be the effect on future investment? You are saying that there are domestic and other factors, or indeed uncertainty over Brexit, and there are other sources even if they are not quite as good. How significant would the loss of EIB investment be for projects that might not

otherwise go ahead?

Pete Clutton-Brock: In the energy sector, my sense is that, although projects might well go ahead, they would be slower to go ahead. Both the EIB and the Green Investment Bank, in the case of energy, have significantly accelerated the transition. That is not to say that investments would not have gone ahead without it. It is always hard to argue the counterfactual, but it is very clear that they have moved things forward faster than would have happened otherwise.

Q22 **Earl of Lindsay:** Mr Williamson, can you say a bit more about your reference to the pre-payment conditions the EIB is now introducing? You said they were linked to the nature of Brexit. Can you say a bit more about what that means?

Piers Williamson: I may be breaching contractual privacy. Conceptually, certainly in my market, the EIB uniquely has sets of pre-payment events. The classic one in my market is that a radical change in the housing benefit regime, for instance, could cause the EIB to require pre-payment. Pre-payment is a way of finessing cross-default if an organisation has the capital to front-run repaying EIB. What have come up in the last two years are pre-payment events linked to specific facets of the Brexit negotiations. I think I would be speaking out of court if I was specific. You might ask EIB what those might be.

Earl of Lindsay: You are saying that certain types of Brexit outcome might trigger a pre-payment event.

Piers Williamson: Yes. Relatively few agreements have been signed in my market in this period. My experience is that those who have agreed those contracts are being very, very careful; they are not drawing the loan before next March, for instance, to make sure they do not get caught by some of this peculiar language.

The Chairman: Does anyone else have experience of that?

Philip Harding: We were negotiating the terms of our loan with the European Investment Bank in 2015 when the fact that we were having a referendum was known, but obviously the outcome was not known at that point. We spent quite a bit of time with the European Investment Bank on pre-payment terms and the events that would cause a pre-payment. We ensured that the outcome from our point of view was one whereby, if we left the EU, which was still uncertain at that stage, under any circumstances, the terms of our loan would be completely unaffected. We were very careful to make sure that the drafting of our loan was fully Brexit proof.

Piers Williamson: I hasten to add that it was the same for us. We negotiated our last loan with the EIB about two months before the referendum, and we were conscious that we did not want to be exposed to that type of risk.

Philip Harding: My understanding from talking to other universities is that they have all received assurances that, no matter what the terms of Brexit are, the terms of their loans will be unaffected.

Alex Conway: We have been working with the EIB on some sort of post-Brexit deal. It may be worth saying, without breaching commercial confidentiality, that there are some standard post-Brexit clauses on how to deal with dispute resolution, for example. From the EIB's perspective it would rest with the ECJ, and from the UK's perspective it would rest with Britain. A middle way has been found.

On Lord Bruce's earlier point, there is no doubt in my mind that the Brexit process is holding up the approval of loans. We have a deal at the moment in relation to loan and equity funds for SMEs for London under the Greater London Investment Fund. The deal is being considered by the EIB's management committee next week, so hopefully we will have some good news very soon, but there is no doubt in my mind that without Brexit it would have been agreed months ago. That has slowed things down, and EIB colleagues are understandably cautious about looking at these matters while the whole Brexit question hangs in the balance.

Q23 **Baroness Liddell of Coatdyke:** Mr Clutton-Brock spoke about the reduction in finance available post the referendum. You talked of a very sudden dip and emphasised it in your paper. Mr Conway has just been talking about some flexibility that the EIB has been showing post the referendum. Does that mean that any outstanding loans and financing will be covered long term by the EIB even if entered into either during this transition period or prior to the referendum? Are there guarantees that there will be cover and has reassurance been given to cover current loans?

Mr Clutton-Brock, you spoke about the establishment of a subsidiary in the future, yet Mr Williamson or Mr Harding pointed out how small the available amounts of money were for non-EU member states. How does all of that fit together? What is the picture for the coverage of existing commitments? What is going on now and what shape will the future be?

Alex Conway: Deal or no deal, the funding for any deal signed with the EIB before Brexit is not endangered. What happens post March 2019 is in my view entirely up for play. One of the big problems with Brexit is that it covers so many enormous areas and certain things, such as Northern Ireland, consume so much of everybody's time that important but ultimately secondary questions such as the UK's relationship with the European Investment Bank, which in an ideal world would be crystal clear by now, are still completely muddy.

The choice is very much with the UK. That is as true of our relationship with the European Investment Bank as it is with Horizon 2020 or any other funding streams. We can choose a very close sort of relationship. Norway is often cited. It is outside the EU but accesses many European funding pots, and, indeed, contributes to them in some cases. We could be a sort of Canada or, in the case of the EIB, a Malawi. To my

knowledge, those discussions have not yet happened. Needless to say, from the mayor's perspective we favour the closest possible relationship, and continual lending on a similar basis to what we have now.

Baroness Liddell of Coatdyke: What about the idea of a subsidiary? How would it work?

Pete Clutton-Brock: You may be referring to an option that I wrote about in the paper. The paper did not necessarily propose and recommend that option, but it talked through the various options available. Going forward, although there are a lot of attractions in maintaining a very close relationship with the EIB, how that would happen is not entirely straightforward. For the UK to remain a full shareholder, my understanding is that a treaty change would be necessary, and that is obviously incredibly complicated, and in all likelihood would not happen.

My understanding is that both the EIB and the UK have been considering alternatives. A subsidiary is one option under consideration already, as I understand it. The problem is that the subsidiary that the EIB is looking into is focused mainly on delivering aid to developing countries, and as such it will be quite hard for the UK to make a strong pitch that it would be a natural home for receiving such finance.

The Chairman: We are a giver rather than a recipient of aid.

Pete Clutton-Brock: Exactly.

Alex Conway: It will all be different post Brexit.

Pete Clutton-Brock: Who knows? The point remains that it will be extremely politically challenging for the EU 27 to provide the UK with large amounts of EIB funding post Brexit. As an option, that has its challenges. That is perhaps why the UK is now considering an alternative by developing its domestic financing infrastructure to replace it.

Q24 **Baroness Neville-Rolfe:** We need to move on to that. The impressive outcomes you described for your organisations and how they have developed projects in recent years would be a joy to the Competitiveness Council, on which I used to sit when we were proactive members of the EU. It was getting into nooks and crannies and providing long-term finance for projects, including those to help small businesses that would not otherwise get them.

Because of the difficulties Mr Clutton-Brock rightly described, we are interested in how we could develop current UK schemes to replace EIB funding. UK guarantee schemes and the affordable housing guarantee scheme have been mentioned. Would those be sufficient? Could they be developed to fill the gap?

Alex Conway: Other colleagues might have a view on housing. An obvious thing that occurred to us is that we could augment some of our existing bodies, such as the Public Works Loan Board. We described

earlier how the EIB has some competitive advantages over PWLB, but perhaps PWLB could offer loans at a discount on its standard concessionary rate and offer what we call starting loans.

One of the important things for Crossrail was that the EIB facility allowed the interest rate and the start date of a loan to be agreed well ahead of the required drawdown, which is not an option available when borrowing from the PWLB or the capital markets. That really helps to manage interest rate risk and the funding risk. We might make tweaks to existing things.

Clearly, there are options, whether it is the British Business Bank or other things. You could augment their lending capacity; some of the cash that is supposedly coming back from the EIB could replace it. There are options, but at this point none is under active consideration as far as we are aware.

Philip Harding: The UK guarantee scheme is important. I know of at least two universities that have access to the UK guarantee scheme. It is not something I am personally very familiar with, but it is potentially a valuable source of additional support for higher education. It relies on universities being able to satisfy certain tests, such as whether projects are of national significance. It would be worth looking at whether the UK guarantee scheme could be extended so that its remit covered more of the policy range of the European Investment Bank, particularly, from my point of view, around innovation and skills, if it does not already. That is valuable.

One of the other aspects of the European Investment Bank that my institution benefits from is access to the European Investment Fund, which is part of the bank. We secured a £25 million investment from it, which will assist in the commercialisation of our intellectual property and research output. More recently, we have had conversations with the British Business Bank about whether it would be prepared to fulfil the role of the EIF, assuming that the EIF is unavailable to us. If work was done there to extend the remit of its role, and its capacity to invest in those areas, it would help.

Piers Williamson: Clearly, I am a fan of guarantees. We have fulfilled that role for four years and have talked to MHCLG about doing more of that.

I have two slightly lateral observations around classification. I am afraid that this is nerdy accounting stuff from a whole nation point of view. One of the benefits of the EIB is that, until recently, it was classified as a remote contingent liability. Effectively, it is off the Government's balance sheet, so it is a fantastic money-printing device for every nation in the European Union. I do not mean that cynically; it genuinely is that. It is about all of those devices if we bring guarantees into the UK public domain.

In housing, we have had a long debate with the ONS about reclassification and then declassification of the whole sector. With £80 billion-worth of debt, it is not actually the stock of debt but the debt servicing that worries the Chancellor of the Exchequer. Whatever is contemplated, be it the British Business Bank, us, or Infrastructure UK, the classification questions and the nature of the risk underwritten by the Government need quite careful consideration.

Homes England as a concept has come on in leaps and bounds in the diversity of risk appetite that it shows, in everything from Help to Buy to supporting SME builders. It is almost a housing investment bank, sitting at one remove from MHCLG. It has a lot of skills and is growing the skills that are needed. Without detracting from what has been said about the PWLB, my experience of it is that it is two or three people in total. You ring up a place in Eastcheap and you get the money, but it does not have the resources to do the detailed credit analysis that comes with project finance. That is something the EIB has been extraordinarily good at, and there are lots of different resources in the UK that do that job. You cannot simply say, "Let's go to the PWLB". You have to reach down a level and ask what the risk appetite of government is for going down a new path, and how you ensure that whatever is done is consistent with that risk appetite.

Baroness Neville-Rolfe: You seem to be saying that there are three or four institutions that could be adapted and improved in the ways you have described. Do you know whether any work is going on as to how that might happen, because it seems quite urgent, given the view that has been expressed about our treatment by the EIB post Brexit?

Piers Williamson: I can only comment in the context of housing, where the process of skilling up and diversification of funding sources has probably been ongoing for the last three or four years. It was not particularly associated with Brexit; it was associated with the fact that capital grant was not available, and different types of revenue subsidy and innovative thinking needed to be in place.

Baroness Neville-Rolfe: Mr Conway mentioned the excellent fund that you put together to help small business, which is a big interest of mine. In the new set-up, is there anything we can do to encourage funding through to SMEs, which is obviously very important for the growth of our economy?

Alex Conway: This will be a very big issue for the Government in their upcoming, much delayed, proposed consultation on the so-called UK shared prosperity fund, which is the means whereby they propose to replace European structural fund programmes. An important thing to remember about those programmes is that the days when they just handed out grants are long gone. We have hundreds of millions tied up now in loan and equity funds, which have been fully invested, are recyclable and have been a success, not just in London but in Wales, Northern Ireland, Scotland and other English regions.

Even if the Government replace the structural funds pound for pound, there will still be the question of where the massive co-financing that has come from the European Investment Bank and other sources will come from. Otherwise, it is not going to work. Our Greater London Investment Fund, at £100 million, is a relative tiddler compared with some of the big schemes in the Midlands, and northern powerhouse-related funding. These funds work and are a very cost-effective way of supporting businesses, but it is not yet clear how the funding will be replaced. Building up the activities of the British Business Bank would be an obvious option.

Q25 The Earl of Lindsay: Should the UK establish its own national infrastructure institution? If the answer is that it should, what would be the benefits of such an institution, compared with the Government stepping in directly and supporting the investment mechanisms you are looking for?

Piers Williamson: I think they have, in some ways, but there may be a finesse in your question. Infrastructure UK was founded at around the same time as we had our guarantee scheme, to provide £40 billion of guarantees to support infrastructure projects. It was founded within government, so it is not a stand-alone institution, but it tooled itself up to handle the analysis of the risk and come up with appropriate financial structures to meet project finance. That may be the seed corn for something that could be a bigger organisation, post event.

We have experienced both the EIB and the KfW; they were both creatures of their time. In competitive terms, they were both founded after the Second World War, going into what was a vacuum, and were able to establish their own processes for undertaking business. If we simply invented a single-nation EIB with a very developed financial services market around it, it might not be able to prosper in quite the same way. There would be all sorts of competitive debates around what that thing was. Whatever is produced needs to be handled carefully. My own view would be pragmatic: that perhaps we should set up seven or eight different institutions with particular expertise where there is an evidenced market failure or shaping role for that institution.

The Earl of Lindsay: Can I press you on that? You would rather see seven or eight institutions than the Government ramping up their support for existing government mechanisms.

Piers Williamson: I am agnostic; I am a pragmatist. Whatever can get through the Treasury is the best solution. My experience of the Treasury is that it is quite picky about this sort of activity, and you have to work to evidenced needs.

The Chairman: There are some former Ministers in this Room.

The Earl of Lindsay: Are there any other thoughts?

Philip Harding: I do not have a view about whether we are better off looking at existing sources of investment support within the UK, and

thinking about how we might extend their reach and remit to cover areas that the European Investment Bank benefits, but it would be my recommendation that we pursue that initially rather than assuming automatically that we need to establish a UK investment bank along the same lines as the European Investment Bank. It is worth trying to capture the particular benefits that access to European Investment Bank funding provides, which are not available elsewhere, and then seeing whether existing institutions, some of which I am familiar with and some of which I am not, can replicate that to a sufficient degree.

Pete Clutton-Brock: Speaking as an ex-Treasury official, I can understand that a very high bar needs to be met to generate a new institution, because they automatically come with new overheads and new costs, so there is rightly that bar. I was in the Treasury when the Green Investment Bank was established, and exactly this debate was had then. The arguments that won the day in that case were that two things were needed for a new institution that wanted to deliver project finance and related financial instruments: the expertise to do so and being able to attract that expertise; and some kind of distance from government to generate the credibility to crowd in other investors.

Other investors who look at the kinds of projects that the Government invest in are highly concerned about the political risks of decision-making, and how long the decision-making processes will take. Over recent years, we have had a couple of examples, such as tidal lagoon projects and Hinkley Point C, where government decision-making processes, whatever you think of the outcome, were very long. For investors to be attracted to invest alongside such an institution, distance from government is really important.

In the energy sector, there are already other mechanisms at play. The UK guarantee scheme operating from the Treasury is a very useful mechanism and has already started to adapt to pick up some of the slack. It is now offering construction guarantees, which is a new thing. It can certainly help to address the vacuum in the short term.

One thing we have not talked about so much in relation to the EIB, which is really key in the energy sector, is its expertise, and how important that is in bringing in other investors. Members of the investment community in the UK who invest in energy projects are much more confident about investing in an energy project where the EIB has already acted as the cornerstone investor. Often more so than the cost of capital, that is a key factor in crowding in additional sources of finance.

The Earl of Lindsay: Do the other witnesses agree that distance from government is a desirable feature for the credibility it gives other investors?

Piers Williamson: I tend to agree with that. We have just been advising the Australian Commonwealth on an equivalent guarantee scheme, which is being formed as a statutory body; it sits in the Commonwealth but has an independent voice from the Commonwealth. Particularly when lending

and investing long term, you need to be very careful not to expose yourself to political whims. The politics can change a great deal in 30 years, so having an organisation that can act independently of government is important. It does not have to be completely independent of government; there are constructs such as halfway houses and non-departmental government bodies. All those sorts of boxes can be fit for purpose, but some independence is really very important for long-term investment.

The Chairman: Mr Williamson, did you say that you had to leave at 11?

Piers Williamson: Preferably, but I think it is very important that we answer your questions.

The Chairman: Thank you. We appreciate that flexibility.

Philip Harding: I want to offer a slightly contrary view, which is that proximity to government has some value. We have seen that in how we have been regulated in higher education. The regulatory regime for higher education has changed quite fundamentally recently; nevertheless, we have benefited from that. Thinking back to conversations I have had with potential investors and lenders, they get a great deal of comfort from the fact that the Government have an active role in regulating the sector by carrying out some level of financial oversight and due diligence on their behalf. We see the benefit from that in the very limited covenant restrictions on lending, more streamlined due diligence processes on behalf of investors and, indeed, keener pricing. There is some merit in proximity to government.

Q26 **Lord Bruce of Bennachie:** I want to pursue the role of the Green Investment Bank, which some of our witnesses said was the best existing model of that kind of institution that has been created. You said that things can change in politics over 20 or 30 years, but it was about five in this case; it is not even a bank any longer, it is now the Green Investment Group, and in the private sector. As you all know, it was a Liberal Democrat proposition for the coalition, which did not survive the end of the coalition.

The point was that it was designed to provide guarantees and government money cheaply, and unlock a lot of private money. Having got off the ground, how important was it in delivering investment in the sector? Can you say something about the effect of its privatisation? Clearly, it is now a different institution, operating on a different basis.

Pete Clutton-Brock: Absolutely. I alluded earlier to the fact that both the EIB and the GIB have accelerated the transition to a low-carbon economy, which would have been slower without it. The GIB got going very quickly and built a strong reputation, which was all credit to the leadership and to the coalition Government of the time for making it in the way they did. It was an emergent design from the negotiations within government.

The GIB says, and analysis suggests, that it has crowded in or leveraged £3.40 per pound invested, so it has brought in a lot of private capital. That was particularly important in the offshore wind market, but in other markets as well. It helped to socialise offshore wind as a new asset class, which was key to making it attractive to mainstream investors. It also did various innovative things around aggregating small energy and clean energy projects to make them more attractive to mainstream investors.

It is something of a shame that the GIB does not exist today, because if it was still in public hands it might be a natural mechanism for replacing some of the EIB financing. Its role today has changed somewhat; it has widened its remit to be more international. The majority of its investments since privatisation have been international, which has reduced funding in the UK, so perhaps an element of focus has been reduced.

During its existence, the GIB never provided below market rate capital, so it was slightly different from the EIB in that regard. It provided capital at commercial rates, partly due to state aid rules and partly due to the remit that it was given by government. That meant that its value added had to be partly in the expertise it could bring in, and the analysis it was able to do on projects, to help mainstream investors understand the technology risk they were signing up to. It is hard to develop a counterfactual argument as to what would happen if it had not existed, and it is the same with the EIB, but it is very clear that it made a major contribution.

Lord Bruce of Bennachie: From what you have said you were on both sides of the table at different times. Regardless of what has happened, is it the kind of model that has some potential for the nucleus of a similar organisation, or organisations, which could step in and provide infrastructure investment in other sectors?

Pete Clutton-Brock: My sense is that, yes, it could provide a model. As my colleague said, the design of any new institution should be driven by need, an assessment of market failures and how public money can be best spent to dissolve those market failures. Since the GIB was created, the market has moved on somewhat. I come back to the example of offshore wind, where the market has matured and there may be less need for such an institution to support that sector, but other emerging technologies are equally in need of support. You could say that there was still a need, but it would need to be reassessed.

The Government have various processes for assessing infrastructure needs. The National Infrastructure Commission came out with a national infrastructure assessment earlier this year. Our suggestion or recommendation is that that needs to be followed by an assessment of where the market failures and the financing for that infrastructure are, and then develop the mechanisms on that basis. If we come up with the instrument before the need, we could get mixed up.

Q27 **Lord Vaux of Harrowden:** You have answered this to an extent already.

In designing a UK financing institution, what are the key lessons that we could learn from the EIB, the Green Investment Bank or from other national institutions such as KfW, the Development Bank of Japan or the Canada Infrastructure Bank?

The Chairman: Can I add a little to that? Mr Williamson said earlier that KfW had to be seen in its context, which was very favourable, and that highly sophisticated and developed modern financial markets are not the ideal background against which to set up a new institution. Canada has just set up a new one. Is that an example?

Piers Williamson: I am less familiar with Canada, I am afraid. I would answer with a question. What is the problem you are trying to solve? KfW and EIB came straight in under the Marshall plan, when there was a need for wholesale investment in everything. They were filling a vacuum. It is not the same vacuum. We have characterised EIB's role as a form of subsidy. In my market, it is cheap funding; it is the cheapest long-term funding that one can get. It is possible to emulate that using a UK guarantee. It is not as good, but it does the job.

To come back to the problem that is being addressed, whatever the proposed solution, I would think of it in the context of the market at the moment, to ensure that the solution is not perceived as crowding out private investment, because that would be a bad thing. In the investment market post credit crunch, banks are much shorter term in their behaviours, and there are fewer of them and fewer large investment funds. If there is diversification of sources of funding, a guarantee is a unique sticking plaster, because most institutional investors do not have limits on how much they are willing to invest in, effectively, the UK sovereign country, but we come back to the question about crowding out.

Q28 Lord Butler of Brockwell: This is really the summing-up question, and perhaps each of you would answer it briefly. If we lose access to the EIB, is it inevitable that there will be a financing gap for projects in the UK? I mean by that a financing gap both temporally, because it will take time for other institutions to be established, and in the cost, because it is unlikely that successor institutions could provide finance at equally competitive rates.

Pete Clutton-Brock: It slightly depends on the outcome we get in the Brexit negotiations as to what the gap will look like. How the market responds to whatever the result is will be key in determining how liquid the private capital markets are and how well they can continue to do their job. If there is a reduction in the appetite of capital markets for long-term project financing after the Brexit outcome and after the UK leaves, there could be an important role for a UK institution to help to address that countercyclical financing gap.

In the long term, on many issues, although the private sector could step in and do the job, riskier projects would probably not go ahead. It is hard to assess exactly what would happen, given that we are dealing with somewhat hypothetical situations, but there is likely to be some kind of

financing gap, certainly in the short term, and, potentially, a structural gap in the long term.

Alex Conway: To start with the concerns of Transport for London, there are alternatives. The Public Works Loan Board is the obvious one in that case, but its pricing and flexibility historically does not match those achieved through the EIB. With future important investments of the likes of Crossrail 2, that might increase the price, which might have an effect on the ultimate viability of the scheme. There is genuine concern.

I remind the Committee of the importance of the UK shared prosperity fund, the replacement funding. It is a vital source of funding for employment and skills and business support programmes, as well as for environmental improvement programmes across the UK, where the European Investment Bank has been a major player in loan and equity schemes. Something to look out for when the Government issue their consultation paper later this year or early next year is what they have to say about encouraging loan and equity schemes, which ought to be a no-brainer for recycling funds, rather than spending them once.

Philip Harding: Assuming that after next March we do not have access to the EIB in future, there is no doubt that there will be a diminution in the rate of investment by universities, particularly in larger infrastructure projects. There will be both a temporary and an enduring effect; the temporary effect would be relieved, potentially, if we could ensure that the EIB was prepared to be flexible in its covenant restrictions. A number of universities have built their plans on an assumption from some time ago that they would have continued access to the EIB and that, therefore, they would be able broadly to replicate the terms of funding in future. If they have to access alternatives, some covenant restrictions of the EIB may bite in a way they had not anticipated. That is an important consideration.

I am also assuming that we are not going to see a return to the old days in higher education, when we were fairly substantial recipients of government capital grant funding. Those days are gone, I think, and we will be increasingly reliant on access to capital markets through bond issues and private placements. The difficulty there, as I mentioned earlier, is that those are substantially more reliant on universities being able to demonstrate their credit status, sometimes by actually getting a credit rating, which a number of universities have done. Access to that funding on acceptable terms will be difficult for universities that have more difficulty in establishing credit status. It is very hard to quantify. Universities have not been such substantial recipients of EIB funding as some other sectors, and there are alternatives, but there is no doubt that it will impede the rate of investment.

Piers Williamson: Without being naive, I am a glass half full kind of guy. If we all accept that lack of EIB funding is inevitable, it will probably happen. The EIB likes lending in the UK, which is its safest national portfolio. Some of its key risk people are actually UK nationals. In a

blinkered sort of way, if you are in the EIB you quite like the UK, but, fundamentally, it is a politically driven institution.

If we have a range of guarantees available, the only terms of trade that may be available to continue to access EIB funds after whatever happens next year will be on a full-faith guaranteed basis. It is important that those guarantees are there and that there is political prioritisation of a new framework agreement between this country and the EIB to attempt to keep the flows happening. It will be a lower priority because of other political pressures, but it may not be zero. My personal job is to work hard to see whether we can build a bridge across what is going on.

Q29 The Chairman: I have a couple of follow-ups that have emerged from the discussion. As we have seen in written submissions and as other witnesses have pointed out, the public sector net borrowing issue is one reason why just putting money into the British Business Bank would be problematic. Are there routes into continuing to supply the kind of funding that would not show up on Treasury books in net borrowing?

Piers Williamson: In my case, it is a matter of degree. For our guarantee scheme, the nature of the risk that has been underwritten and the mechanics of it make the likelihood of a claim under the guarantee very remote, so it turns up on the government balance sheet, but it is only an infinitesimally small amount. There are many ways to finesse the question you asked.

The Chairman: Mr Clutton-Brock, can you give us your insight and knowledge of the Treasury?

Pete Clutton-Brock: The reason why EIB finance does not show up on the UK's books and why a new national infrastructure bank, or whatever it would be, would show up, is that there is an accounting rule that, if the UK has a controlling share in said institution, it falls 100% on to the UK's books. That is usually interpreted as greater than a 50% shareholding. There is substantial advantage in multilateral banks such as the EIB, where the UK has a lower than 50% shareholding, because there is zero show-up on the balance sheet. That is quite attractive from a fiscal perspective, and, in particular, when the Government are trying to meet targets for minimising public sector net debts, it is of significant interest.

The alternative, although it is a somewhat unlikely or left-field suggestion, is that the UK could consider trying to develop a new multilateral institution, together with other interested countries.

The Chairman: Such as the Asian Infrastructure Investment Bank.

Pete Clutton-Brock: Exactly, yes. Something along those lines would have fiscal attractions. I am not saying that it would be easy; there would certainly be political challenges in doing so, and you would need to make sure that there were interested potential shareholder countries, but it could solve the problem.

Piers Williamson: I had a debate with the NAO about four or five years ago on the whole of government accounting, where I was one of the balloons when it was looking at who was on the government balance sheet; THFC was on it. Our legal construct creates the same effect as a multilateral nation. It is not beyond the wit of man to come up with appropriate structures that finesse that particular accounting rule.

The Chairman: That is interesting. Thank you.

Lord Vaux of Harrowden: I have a small follow-up question for Mr Harding. You mentioned the covenant point. Previously, although I forget who said it, we talked about how any loans already in place would not be affected by Brexit, but that covenant point sounds like an exception, if I understood it correctly.

Philip Harding: The point I was trying to make is that it is not the existing loan that is affected but the ability of that institution to borrow subsequently, potentially from another lender.

Lord Vaux of Harrowden: Because the EIB loan agreement does not allow it to do that.

Philip Harding: Or it places restrictions on it that make it difficult. I am not aware of any EIB loan that actually prohibits an institution from borrowing from other lenders, but it will generally have some provisions in its funding that allow it some right of approval or the ability to have oversight, because potentially it affects the security of the existing loan. Some institutions will have negotiated loans on the assumption that they would have ongoing access to EIB funding.

The Chairman: In your estimation, do you see any possibility of the EIB continuing to lend to UK institutions during the transition period?

Piers Williamson: It depends on the deal that is cut.

The Chairman: In other areas the transition period is meant to be same state.

Piers Williamson: This is a bargaining chip, so it depends what else is going on.

The Chairman: I am being corrected; it is called the implementation period. I still think of it as the transition. Thank you all very much indeed for your time.