|  |
| --- |
| Wednesday 22 June 2022 |

|  |  |
| --- | --- |
|  | Update to the Green Finance Strategy, call for evidence  |
|  | London Councils’ response to Government Call for Evidence |

|  |  |  |
| --- | --- | --- |
|  |  |  |
|  | **London Councils represents London’s 32 borough councils and the City of London. It is a cross-party organisation that works on behalf of all its member authorities regardless of political persuasion.** |  |
|  |  |  |

London boroughs are strongly committed to investment in climate change mitigation and adaptation. Many have declared a climate emergency, and all will be making changes in their own local areas through climate action plans. They are also working together in our seven collaborative climate programmes to share best practice, join up activity, and grasp economies of scale. Lack of finance is a major impediment to implementing these programmes and we need to work in partnership with private finance to bridge the funding, skills and operational gaps needed to mobilise resources. We work closely with the GLA.

We also know that to maximise the boroughs' contribution, national government must put in place a clear policy framework for ensuring that there are economic and financial rewards for projects that deliver climate and just transition outcomes. Development finance support is needed if private capital is to be leveraged to ensure projects have a risk-return profile that private investors will find acceptable.

The below is a London Councils response to the relevant questions in the Government’s Call for Evidence.

**Local Authority questions:**

**17. How can the UK financial sector support the delivery of the UK’s climate and environmental objectives at the local level, whilst also benefitting local growth and communities?**

The UK financial sector can support local government in three important ways.

1. **Quantum of finance**: Private finance is needed to bridge the funding gap between the net-zero investment needs as well as the resources available from grants and local taxpayers.
2. **Suitable instruments**: Private finance needs to design financial products that meet local governments’ funding needs. Local government assets are typically long-lived, place-based and might consist of many individually small assets (like buildings or schools) that need aggregation before being suitable for institutional funding.
3. **Place based investment**: Support local government efforts to encourage local economies. This can be through a mixture of investment, job creation and supporting policy development.

Quantum of finances: London boroughs do not have the resources to fund all the projects required to achieve net zero targets in their own estates, or to assist SMEs and residents within their boundaries. A partnership between local authorities and private finance must be established. Boroughs can provide a pipeline of projects that have been vetted for reliability and achievability whilst private investors can provide supplementary funding to ensure investment occurs.

Work undertaken for the UK Cities Climate Investment Commission (UK CCIC) has identified an investment need of £206 billion to meet net-zero in the twelve core cities and London boroughs [[1]](#footnote-2). Many of these projects could provide a reasonable long-term rate of return to private investors if the financial package is appropriately structured and if investors, like pension funds, are looking for longer term investments.

One London borough has remarked, “Development finance to bring a project to market is extremely difficult to access plus our experience is that it is exclusively provided by government (e. g.: Green Heat Network Fund Transition Scheme).” UK100 have indicated favourable levels of leverage with £5 billion of development funds unlocking up to £100 billion of investment. Local authorities have had some success from Community Municipal Investments, but government could support research in to scaling up local investments (>£1m not tested).

Suitable instruments: London boroughs need the finance sector to develop appropriate financial products. These will aggregate place-based, often quite small projects perhaps with different risk – return profiles into packages suitable for institutional investment. Funds are also needed for large single assets e.g. heat networks which have difficult to characterise risk profiles.

Some place-based projects will suit impact investors as they generate non-financial benefits such as addressing fuel poverty, or socially deprived communities.

The new financial products need to aggregate large numbers of small local investments like home retrofits, solar roofs, electric vehicles, business loans for emerging green businesses. Instruments like themed revolving funds (for example to fund roof-top solar or heat-pump roll-out) need to be made available to residents and SMEs perhaps drawing on local government to raise awareness or support their usage. Local government can sometimes provide or access grant funds to supplement private capital and reduce commercial risks. These blended finance solutions need to share the risk and returns between the public and private sectors on a fair basis.

More work would be welcome on delivery models (e.g.: Joint Venture/ESCOs) and how to unlock £340bn of assets inside local authority pension funds.

Place based investment. Private investors can help deliver local community benefits by involving them in co-creating the net-zero investment programs and adopting a place-based approach. The UK CCIC report recommends a combination of complementary interventions with differing internal rates of cash returns and non-cash co-benefits. More profitable investments can provide the cash returns to support a layer of private finance. For this to happen, this will require contracting mechanisms to capture, say, the energy savings from residents who benefit from the investment at no upfront cost.

The use of local supply chains will ensure local communities’ benefit from the delivery of climate and environmental objectives. Ensuring co-benefits remain in the community will be important and this begins with using local resources to carry out the work.

**18. How can local authorities support the mobilisation of private and public investment to key sectors and technologies for the UK’s climate and environmental objectives, whilst also meeting local priorities? What barriers to this are there?**

Local government plays the following roles in mobilising investment, encouraging innovation, identifying local priorities and developing and co-ordinating net zero projects. It:

* Sets the political direction
* Develops strategies to decarbonise communities and identify investment needs in public and private assets at both the individual authority and collectively across authorities
* Supplies (constrained amounts of) low-cost capital or grant to blend with private capital
* Helps develop local skills
* Removes obstacles and ensures local policies and plans incorporate net-zero
* Identifies national policy changes needed to strengthen the financial case

Political direction: London’s local politicians have demonstrated their intent to reach environmental targets, with 28 of the 32 boroughs and City of London declaring a state of climate emergency and 31 boroughs and the City of London declaring net-zero targets for 2040 or earlier.

Strategies: London Councils have established seven programmes of activity to plan London’s green transformation focussed on buildings, transport, energy, upstream supply chains, enhancing local skills, green economy and investment to make London more resilient to climate change[[2]](#footnote-3).

Local authorities need to play a key role in developing a project pipeline to identify the investment need to reach climate targets. These can help aggregate many individual projects into quantities that can appeal to debt capital markets (which often needs a minimum size >£100 million). London boroughs would ideally draw up robust business cases to attract investors to projects seeking funding.

This is a major task and London boroughs have worked through the UK Cities Climate Investment Commission to produce an overview pipeline of investment needs[[3]](#footnote-4). We are requesting input from public bodies in London to develop a bottom-up pipeline of investment aspirations and plans. Boroughs are being asked to identify single and multi-asset net-zero projects that public and private bodies would like to see financed. These are being categorised according to their maturity, ownership and whether there is a revenue stream that can be used to repay investors. The Retrofit London programme has modelled the need for £49 billion of investment to raise the average energy efficiency of London homes to EPC B, and £98 billion to make the homes net-zero.[[4]](#footnote-5)

Local Boroughs can enter into partnership financing for schemes such as bridges, highway improvement or shared land and assets. This allows cross borough working without individual boroughs taking all the risk.

Grant funding: local government can access central government schemes for statutory duties like waste collection and disposal, social housing provision, and specific grants to decarbonise the local economy. These grants can be combined with private capital to enhance the return for unviable projects, or bear some of the policy risks.

Local skills and local business development: Skills and capability need to develop sufficiently to enable this transition to take place. The scale of need for work in retrofitting buildings alone means a requirement for thousands of skilled jobs as well as opportunities for businesses and suppliers. In London, it’s estimated that over 110,000 jobs would be created – an important boost for the economy. It is projected that the number of jobs in London’s green economy will more than double by 2030 and quadruple by 2050, with four economic sectors comprising the bulk of those jobs: Green finance, low-carbon transport, homes and buildings, and power. Commensurately, each sector will encounter challenges sourcing the necessary skills and investment needed to create such jobs, and local government is well placed to serve as a leader and co-ordinator in this aspect.[[5]](#footnote-6) Local government can play a major role in identifying skills shortages, working with educational bodies and trades to provide appropriate training, using procurement to pump-prime markets for new technologies like air-source heat pumps, novel retrofit technologies. (London boroughs have trialled the use of infra-red cameras to locate poorly insulated homes, experimented with robots to install underfloor insulation.)

Planning and local economic plans: There are some policy changes that local government can make to simplify net-zero investment such as energy-efficient retrofitting its own buildings, changes to car parking provisions or use of permitted development.

However, more needs to be done at the national level specifying higher energy efficiency standards for new build or retrofits through building regulations, or the inclusion of renewable energy in new developments. Local government has found it difficult to apply standards going beyond national building standards as developers argue that higher standards hurt the *viability* of the scheme, especially when local authorities are asking developers to provide social housing and community infrastructure.

Local authorities’ role in identifying priorities and developing projects: There is a very important role for the local and regional government here as they have the local knowledge and understanding of what is happening at a local level and how best to engage stakeholders and deliver these projects. Local Authorities lack the resources to develop the business cases for investments needed to deliver their low carbon investment strategies. Often policy officer time is taken bidding for piece-meal grants. This means the bidding process is very resource intensive relative to the value of the grants. Whilst it may be impracticable for there to be an appropriate level of expertise and resource in each local authority there is an opportunity to develop a regional model such as has been developed in London. The government has announced £22 million in funding for the creation and continuing support of five Local Net Zero Hubs. The Hubs promote best practice and support local authorities to develop net zero projects that can attract commercial investment.

Barriers faced by local government: Currently, local authorities face substantial barriers to attracting private capital to fund their strategies. The figure below shows how several market failures frustrate investment in low carbon opportunities. Only renewable energy is deemed as well suited to private sector investment through the specific policy support via the contract-for-difference and renewable heat incentive policies.

Investments in the local government programmes cannot easily be financed from commercial sources because of the principal-agent issues (where assets owners are asked to invest in low carbon measures but the benefits cannot be recouped from higher user charges), lack of rewards for non-market benefits like biodiversity, carbon and health gains. The same is true for other environmental goals such as promoting circular economy or reducing micro-plastic and water pollution.



Source: CCIC Report “City Investment Analysis Report”

**19. What is the current state of capability within local authorities to attract investment, and how can it best be supported?**

London local authorities have traditionally financed their investment from a mixture of capital grants or borrowing from Public Works Loan Board which offers finance on favourable terms (though the debt is on the local authorities’ balance sheet).

Islington and London Councils through the UK CCIC is in early discussions with UK Infrastructure Bank around potential funding for our capital programmes and has a positive working relationship with the Green Finance Institute. London councils would like to see an acceleration of the planned ‘expert advisory service’ at UKIB and it is hoped it would be at no extra cost to borrowers. If projects can be aggregated through UK CCIC, more support is required to develop concepts into investable business cases (e.g.: government financial advisory service or similar).

The GLA has experience using blended financing funds through the London Energy Efficiency Fund and now the Mayor’s Energy Efficiency Fund (MEEF). These programmes showed how regional funds work best at attracting additional local funds and can respond to local decarbonisation needs and drivers.

Government should publish a live database of all investment opportunities plus review application windows that are often too demanding for local authorities to complete to a high standard/submit at all.

Local authorities with social housing will have a higher degree of sophistication in accessing debt capital markets to fund their housing projects. Financing green investment programmes means funding a much wider range of assets some of which are owned by public bodies, some by business, some by residents or SMEs. Some assets, like waste infrastructure, might be designed, built and operated by private sector under public-private partnership arrangements in which local authorities ultimately must service the debt even if private sector is responsible for sourcing finance.

Councils have much less experience at raising finance for assets like heat networks, EV charging infrastructure, retrofitting council owned or privately-owned buildings. In general, many authorities lack depth in capability to attract private investment via instruments like green bonds or structured finance, or partner with large investors like pension funds, insurers, private equity or venture capital. Due to resourcing constraints, capability has not been able to develop sufficiently in this area and progress has been stalled accordingly. As the Green Finance Institute’s ‘Retrofit Funding propositions’[[6]](#footnote-7) finds, there are important roles for local authorities to play if resource and capability challenges can be addressed.

Local authorities have a skills gap and capacity constraints to create project pipelines and write the business cases to bring projects to market. This could be addressed by supplying development funding and supporting a capacity and co-ordination and regional role for London Councils and GLA in London.

The UK CCIC is researching the extent of skills gaps and how they might be remedied. But realistically it is not possible for every local council to develop such expertise and so it is important that centres of excellence are developed to advise local government. For instance, the UK Infrastructure Bank and the Green Finance Institute might have the right sorts of skills but would need to scale up if they are to advise all local authorities.

Whilst there is a need to develop skills and capability to attract green finance, this is no substitute for developing smarter policies. The reason for the success of renewable energy over the last 20 years has been a succession of policies that incentivise investment. Other assets like buildings need similar inducements to attract private capital.

**20. How can the UK financial sector support SMEs and retail customers to align with the UK’s climate and environmental objectives?**

This question is more for the financial sector, but local authorities can play an important role as procurer and aggregator. Some local authorities have established local electricity supply companies to procure green electricity on behalf of residents and local businesses (green tariffs or green power purchase agreements). The UK financial sector could in principle support this by encouraging their own customers to use these mechanisms.

The UK financial sector can also play an important role in financing the decarbonisation of homes and businesses. Products like green mortgages, green savings products and green pensions are useful tools for small businesses and retail customers to borrow and save for green use of purposes.

**21. Is there a role for the UK government to facilitate broad access to green finance for local authorities, SMEs or retail customers? If so, what should these roles be?**

Regulatory and taxation policy needs to be developed by national government to ensure the financial viability of the net zero investment programmes. The private sector needs to have confidence in government policy (e.g.: new technologies, upskilling workforce) and needs to be convinced that development finance/first loss capital has long-term benefit.

The introduction of the UK Infrastructure Bank is welcome (and is competitive vs PWLB) however the MBA appears limited as a solution (£250m+) and perhaps should be re-evaluated.

Government should develop and promote more standardised business cases and as above provide more upfront finance to help de-risk investment.

The national policy framework does not adequately reward the social and environmental benefits arising from less pollution, more circular material flows, better biodiversity and lower carbon emissions from green investment programmes. The reduction of these externalities does not appear as ‘revenue items’ in the investment decision. Environmental tax reform, payments for environmental services could remedy this.

Investment can also be encouraged by substantially increasing the quantum of money and reducing the interest rate that banks (including the UK Infrastructure Bank) have available to deploy in low carbon projects. Central government could support London to develop the project pipeline by funding a regional hub with development funding that supports LAs in the development of their NET Zero projects.

One approach worth considering is a green refinancing window where the Bank of England supports lending to green projects by offering cheap finance. The Bank of Japan (BoJ) has developed such facilities and refinances commercial loans to green lending at 0% for up to ten years[[7]](#footnote-8). The low-cost funds supplied by the BoJ are lent by retail and investment banks for qualifying low carbon investments. In the UK, this could be a particularly valuable tool in view of likely increases in the interest rate as monetary policy tightens. The definition of qualifying assets might be linked to the UK green taxonomy of sustainable finance which government aims to publish in due course.

In Europe, the German development bank KfW has long offered discounted interest rate loans for retrofit programmes where the reduction in interest rate is tiered according to the ambition of the retrofit.[[8]](#footnote-9) Again the funds (and grant support) can be routed through commercial banks so they can develop low-cost lending programs for their customers to finance improving their energy efficiency.

As the experience of the Green Deal showed us a decade ago, low cost finance is not enough to stimulate uptake of energy efficiency. Central government must also create the expectation that home-owners are expected to decarbonise their homes. One approach might be to signal the requirement that homes marketed for sale or rent must attain minimum levels of EPC that become tighter over time.

On the issue of funding local government, the national government can simplify matters for officers by increasing the amount available at one time to local authorities and giving them greater discretion on how resources are spent. Completing the bidding process for small amounts of funding is resource intensive and authorities must compete against one another.

1. https://cp.catapult.org.uk/project/uk-cities-climate-investment-commission/ [↑](#footnote-ref-2)
2. www.londoncouncils.gov.uk/our-key-themes/climate-change [↑](#footnote-ref-3)
3. https://cp.catapult.org.uk/project/uk-cities-climate-investment-commission/ [↑](#footnote-ref-4)
4. [Retrofit London Housing Action Plan | London Councils](https://www.londoncouncils.gov.uk/our-key-themes/climate-change/retrofit-london-housing-action-plan) [↑](#footnote-ref-5)
5. http://wpieconomics.com/site/wp-content/uploads/2021/10/Green-Jobs-and-Skills-in-London-Final-Report-1.pdf [↑](#footnote-ref-6)
6. [New report on local authority retrofit finance (greenfinanceinstitute.co.uk)](https://www.greenfinanceinstitute.co.uk/news-and-insights/new-report-on-local-authority-retrofit-finance/) [↑](#footnote-ref-7)
7. [BoJ to offer zero-interest loans for climate projects - Central Banking](https://www.centralbanking.com/central-banks/monetary-policy/7856316/boj-to-offer-zero-interest-loans-for-climate-projects#:~:text=The%20BoJ%20will%20offer%20zero,will%20be%20against%20pooled%20collateral.) [↑](#footnote-ref-8)
8. [Energy efficiency, corporate environmental protection and renewable energies | KfW](https://www.kfw.de/inlandsfoerderung/Companies/Energy-and-the-environment/) [↑](#footnote-ref-9)