



**Consumer  
Focus**  
Campaigning for a fair deal

# **Consumer Focus evidence to Environmental Audit Committee Inquiry: Green Investment Bank**

**October 2010**

# Executive summary

This submission covers those activities of the Green Investment Bank (GIB) which might improve households' and communities' access to funds to adapt to or mitigate climate change gas emissions and any role households might play in providing capital to the bank. We have drawn on examples from other countries, especially Germany's KfW which might provide a useful template for the activities of the GIB. Consumer Focus has no views on the GIB's lending to business.

A Green Investment Bank (GIB) should be used to address the market failures in domestic energy efficiency.

There are three important market failures:

- Firstly, a low cost financing mechanism is needed to develop immature industries like solid wall insulation. Because of their high cost and long payback period homeowners will be deterred from taking action
- Secondly, some measures need geographic co-ordination to achieve economies of scale. These include district heating and some community climate change adaptations. (This will need Defra to develop an appropriate regulatory framework)
- Lastly, the GIB might play an important role in providing working capital to smaller and not-for-profit Green Deal providers

Access to low cost finance and grants is needed in addition to legislation allowing the Green Deal repayment to remain attached to the house's energy bill

GIB needs to provide services in addition to those supplied by the existing marketplace.

GIB could explore the possibility of raising capital funds from retail savers through green ISAs and public sector pension funds.

## About us

Consumer Focus is the statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, Northern Ireland. We are the voice of the consumer and work to secure a fair deal on their behalf.

# Market barriers

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- the significance of any barriers or ‘market failures’ requiring the establishment of a Green Investment Bank and any risks of not getting this done quickly

There are numerous market failures that inhibit homeowners or tenants from undertaking energy efficiency improvement to their homes even if it appears they have a financial interest in doing so. Reviews by the previous Government have highlighted some of the supply side weaknesses (eg Commission on Environmental Markets and Economic Performance (November 2007<sup>1</sup>)) such as the lack of capacity in suppliers and in the local Government. There are also demand side weaknesses (see studies undertaken for the Energy Efficiency Innovation Review, 2005; Oxera’s paper has a good overview of consumer barriers<sup>2</sup>) such as unfamiliarity with technologies, hassle costs, landlord-tenant issues and poor access to capital.

There are three specific market failures that the green investment bank could and should address.

Infant industry and the lack of supplier competition: some of the technologies are likely to become cheaper as the market matures. In time the production process will be improved providing economies of scale and also there will also be more competition among suppliers. This is especially true of the retrofit solid wall insulation industry and some parts of the renewable heat industry. In 2008 roughly 13,000 homes were retro-fitted with solid wall insulation<sup>3</sup> from a stock of around six million homes with solid walls. This sector has a huge potential to save energy. The average installed cost was £12,600 for individual homes. At present energy prices the payback is 20 years or more, which would deter many homeowners. We have also heard anecdotal stories that installers charge high mark-ups because of transaction costs, associated with the newness of the technology, and little local competition. The commercial viability of renewable heat and solid wall insulation is highly sensitive to interest rates. Low cost finance from an investment bank tasked with growing a low carbon economy could overcome ‘first mover’ (both consumers and suppliers) disadvantages and bring down costs and allow these technologies to mature and become financeable from conventional sources.

Co-ordination: Communal mitigation technologies like electric vehicle recharging points or district heating networks have difficulty in accessing finance. Their projected revenues are low in the early years and only build up as customer numbers grow. Interest-during-construction and interest-during-market penetration becomes a significant proportion of the total costs. In both cases low interest finance greatly improves the viability of the infrastructure, by providing working capital / bridging finance while the revenue streams develop. Such investments could be refinanced commercially when the customer numbers have grown. The European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) have both financed such communal low carbon assets.

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<sup>1</sup> <http://bit.ly/9v2Zdm>

<sup>2</sup> <http://bit.ly/bNHS87>

<sup>3</sup> EST and Energy Efficiency Partnership for Homes (May 2009) *Solid Wall Insulation Supply Chain Review*

Climate change adaptation measures like retrofitting sustainable drainage systems (SUDS) to hard surfaces and green spaces when they are renewed, offer a cost-effective opportunity to reduce expenditures to manage flood risk in areas prone to surface water flooding. At present it is a little unclear how the savings from those liable for mitigating and compensating for these costs: water companies, local government, homeowners and home and contents insurers will be routed back to the SUDS project sponsor. Work needs to be undertaken by Defra in establishing the appropriate regulatory framework.

Working capital to improve hard-to-treat buildings: energy efficiency projects in older buildings will have a positive but unspectacular internal rate of return (eg 4 to 8 per cent). These might include improvements to the heating system, draught proofing, underfloor and ceiling insulation, but will be judged as quite risky. (The Government is considering introducing support through the Energy Company Obligation for solid-wall-insulation.) Venture capital will not be interested in financing such schemes because of the low rates of return. Other classes of investors (eg pension funds) might judge these returns as adequate but not be prepared to accept the project risk while the work is being undertaken. The GIB might play an important role in providing the working capital to Green Deal providers especially those in the voluntary sector that could undertake low cost energy efficiency work in their communities but cannot access working capital. Once the work is complete the risk profile will change (reduced dramatically) and could be refinanced through other funding sources (like pension funds). The EBRD has routed its investment through local retail banks which then lend to households and small businesses. This might be an alternate model rather than lending to Green Deal providers directly. Such 'credit lines' to retail banks have been developed in Serbia, Bosnia and Herzegovina, FYR Macedonia, and Montenegro<sup>4</sup>. Loans to households have typically been for €1,500.

## Objectives

- the objectives and roles the Green Investment Bank should assume, the areas it should operate (and not operate) in, and how its lending and investment decisions should balance green benefits against financial risks;

Government already has numerous policies to incentivise or regulate particular 'green' outcomes. These include banded Renewable Obligation, landfill taxes, Feed-in-tariff, possible renewable heat incentive, possible future floor prices for EU-ETS and carbon reduction commitment. Project sponsors will already take these incentives into account when devising a project for investment. We don't see any virtue in providing further guidance to the GIB aside from a general requirement to promote investment in communities and business to achieve low-carbon and environmental objectives. The objectives might refer to the particular market failures which deter investment. Our view on this is given above.

We believe the Green Investment Bank should be free to decide which projects it chooses to invest in: including projects on domestic energy efficiency. So far little detail has been given on the type of projects it will fund. The press notice accompanying the Deputy Prime Minister's speech in August on low carbon business support said:

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<sup>4</sup> <http://bit.ly/bBSKUF>

'The Government also plans to create a Green Investment Bank to deliver financial interventions to deal with market failures specific to green investment, stimulating growth while supporting environmental objectives.' Meanwhile, the Government's Green Deal will provide a mechanism for financing the energy efficiency retrofitting of homes at commercial interest rates.

Legislation will allow the Green Deal repayment to remain attached to the house's energy bill. We believe this is a useful innovation but insufficient to increase the uptake of energy efficiency of hard to treat homes. Access to low cost finance and grants is needed too. We see no reason why households should be excluded from accessing GIB finance. Investments that help homes decarbonise will make the UK less dependent on imported sources of energy and will employ local people. Economically this is equivalent to growth in our exports.

### Investment priorities

- the Green Investment Bank's investment priorities, and whether and how the bank should support and foster areas where the UK has emerging green technology strengths; and

We agree with the need to foster areas where the UK has technology strengths or which are likely to be internationally important. We believe the avoidance of using imported energy provides equivalent benefits and should be given equal priority.

If Government wishes to provide additional support we would like to see investment in technologies that help communities mitigate and adapt to climate change and which address other environmental problems: eg sustainable drainage, community energy, provision of working capital to SMEs working in green investment, and the early stage retrofit of hard to treat homes.

The GIB should also have mind to increasing on what the market is already prepared to lend to. It might have an eye to develop technologies and projects that venture capitalists will neglect ie those with low rate of return even when mature, but which have a large carbon saving potential.

### Sources of finance

- the funding and governance structures required to create an effective and accountable body, including the role of 'green bonds'.

We are aware of the idea of the green bond but are uncertain how these would operate in practice. Most public sector investment banks like EBRD, EIB and KfW issue conventional bonds at costs of finance based on their creditworthiness. These have to varying degrees the backing of national or local Governments, or capital injections. As a result they can lend relatively cheaply. If Government allowed the GIB to issue bonds either directly or through the Debt Management Office it could access capital based on the UK's credit worthiness – around 4 per cent presently (rate based on a long-dated bond).

Households can provide a useful source of capital for the GIB. Many households are interested in ethical saving; they have short term saving needs (like savings accounts) and long term saving needs (like pensions). Commercial banks are presently offering poor savings rates, and the rates of return from pension plans have also been disappointing of late. Attracting capital from households offers an attractive possibility and they might be a cheaper source of finance than the money markets, especially if given tax advantages.

Cash ISAs are a tax sheltered form of saving popular with households – savers currently have £158 billion invested in cash ISAs with the leading high street banks. The average interest rate being paid on cash ISAs is presently only 0.4 per cent. Over the past ten years ISAs have paid +/-0.5 per cent above LIBOR<sup>5</sup> which has tended to be close to the base rate. This suggests if the GIB were able to issue a tax-exempt savings vehicle it might be attractive option for retail savers as well as being a cheap source of finance for the GIB.

We note that the National Savings & Investment (NS&I) used to offer an index linked savings certificate (RPI plus 1 per cent today worth 5.7 per cent) for a fixed three or five year term. Because the interest was free of income tax, this was worth considerably more to the higher rate tax-payer. This was withdrawn without notice in July 2010 because of the crowding out effect this put on inferior savings products offered by commercial banks. This was a very popular savings product and attracted £5.4 billion of savings in the last three months of its existence (a 69 per cent increase on year on year). This suggests that NS&I might be an attractive way of accessing retail savers.

Public sector pension funds are another mechanism for directing long-term community capital into the GIB. Toronto City public sector employee pension fund has a majority stake in the city's innovative district cooling system Enwave investing approximately C\$250 million in the facility<sup>6</sup>. The appeal of this mechanism is that it avoids some of the transaction costs and fees of accessing the conventional money markets.

Companies are starting to be affected by climate change through impacts on their assets, costs and revenues. Specific risks companies face from climate change have been classified into five broad categories

- regulatory risk
- physical risk
- litigation risk
- competitiveness risk
- reputational risk

Our review of the impact of climate changes on choices made by today's consumers<sup>7</sup> found that their long-term investments are likely not to be managed with climate risks in mind, even amongst ethical pension funds. 'Green' investments must adapt to as well as mitigate climate change risks.

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<sup>5</sup> Consumer Focus (April 2010) 'Cash ISA Super-complaint'

<sup>6</sup> Vaze P, Tindale S and Meyer P (forthcoming 2011) *Repowering Communities* Earthscan

<sup>7</sup> <http://bit.ly/aSOaYZ>



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