A UK Infrastructure Bank

An ACE conversation starter

An ACE publication

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Association for Consultancy and Engineering Alliance House 12 Caxton Street London SW1H 0QL
T: 020 7222 6557 F: 020 7990 9202 consult@acenet.co.uk www.acenet.co.uk

A UK Infrastructure Bank (UKIB)

ACE suggests

- That the UK government explores the setting up of an infrastructure bank.
- A UK infrastructure bank can help map out a strategic direction for the UK's infrastructure.
- An infrastructure bank is a key method of delivering new investment through the issuing of infrastructure bonds.
- The UK needs a financing mechanism which can meet the investment needs of big long-term projects which will be at the heart of a sustainable economic future and kick start the construction industry.

The bank

The bank would help identify investment priorities and regulatory reforms needed to efficiently deliver investment in national infrastructure networks. An infrastructure bank could also be central in establishing a five year national infrastructure audit to help direct required investment and essentially unite public and private capital under professional leadership and government sponsorship.

Infrastructure assets are becoming increasingly expensive but the key question is not the value of such investment but the cost of not investing. When infrastructure is well planned, managed and financed the overall benefit always outweighs the initial cost. In a challenging economic environment such analysis is indeed pertinent. We need to look ahead to the future and appreciate infrastructure as key to economic growth and local regeneration.

The UKIB would issue revenue bonds, make long term loans and provide interest enhancements on loan stock to fund the capital investment and maintenance of transport, energy and environmental systems. The bank would then have a dual role as an infrastructure fund and a leverage programme for private capital[1].

The Bank would have its own legal personality and because of the volume of money it raises on the wholesale markets and the long term nature of such investments it would be able to command a low credit rating. In a financial system recovering from a financial crunch ensuring economical funding is critically important. This is where an infrastructure bank can help provide solutions.

The government's role

The government should set up an infrastructure bank as a statutory body that would be similar in scope to BNDES in Brazil, KfW in Germany and the EIB in the EU. The public element of the Bank would then entail using tax payers capital more effectively in pursuing strategic infrastructure objects in a new legal and cultural entity. Thus, the Bank would be capable of issuing its own infrastructure bonds – known as municipal bonds in North America – directly to institutional and retail investors and local communities. With such an infrastructure deficit in the UK, the potential project pipeline and investment candidates should be significant. Any construction project seeking government assistance above a set value threshold would need to be proposed to the Bank.

[1] *Essentially multiplying capital through issuing bonds securitised by loan repayments that are paid back and raise more funds for the investment programme.*

The Bank would then harness the wholesale markets and the sovereign class security (high credit quality and low risk rating) of such a bank's debt to raise more funding through bond issuance and certain fiscal receipts as well as loans specifically for infrastructure objectives. The Bank could be more than a middle man just directing government funds it would also be able to raise money direct from the capital markets.

With an implicit government role in the Bank, infrastructure bonds should not be that more expensive than government debt although we realise that there would need to be a slight premium on gilts. Although the banks securities will be primarily examined by the capital markets to ensure discipline, efficient exposure and strategic success.

The key functions of the bank would then be to finance feasible capital projects as well as borrowing on the money markets for the same end.

The Bank's lending activities will help finance a broad range of projects to maintain, replace and build infrastructure assets in conjunction with public private partnerships, tax-free incentives (for capital expenditure bonds) and innovative regulatory approaches. Similar debt such as 'Build America Bonds' usually offer tax credits (a government subsidy on interest on the bonds to bondholders) or direct payment (a subsidy direct to the Infrastructure Bank paid as a refundable tax credit). Infrastructure bonds are often fixed income securities which are attractive to investors as they help offset the volatility of their portfolio through a stable allocation of interest.

Harnessing the capital markets

Private investors would be central to deciding whether individual projects were economical and worth investing in. This effective rating in action would help the bank raise substantial resources to plough into infrastructure spending as well as attracting long term institutional investors. Moreover, private banks and financial organisations should be allowed to issue bonds free of capital gains in order to fund such infrastructure projects.

There are trends towards increasing private participation in refinancing infrastructure assets in America such as the Chicago Skyway and the Indiana Toll Road assets by such players as Macquarie and Goldman Sachs. These deals involve the local authority selling such assets and the right to set and collect charges to private companies. Money raised can then be re-invested in new infrastructure assets. User charging on infrastructure assets – as discussed infra these would be funded by revenue bonds – funded by the revenue stream of usage.

In this conception the Bank could be an off balance sheet agency. As well as issuing bonds and raising loans an added benefit of being able to multiply this amount by leveraging private investment. Thus every £1 of bank activity could lead to several more in investment funds. Over the longer term the bank could because a public-private institution. As part of the national infrastructure audit the banks financial account would be able to elucidate whether the UK is investing in infrastructure faster than it depreciates.

For further information please contact:

Adam Patterson
Economic Analyst
apatterson@acenet.co.uk
020 7227 1882

Simon Goldie
Director, Policy and External Affairs
sgoldie@acenet.co.uk
020 7227 6557