# Investing in infrastructure

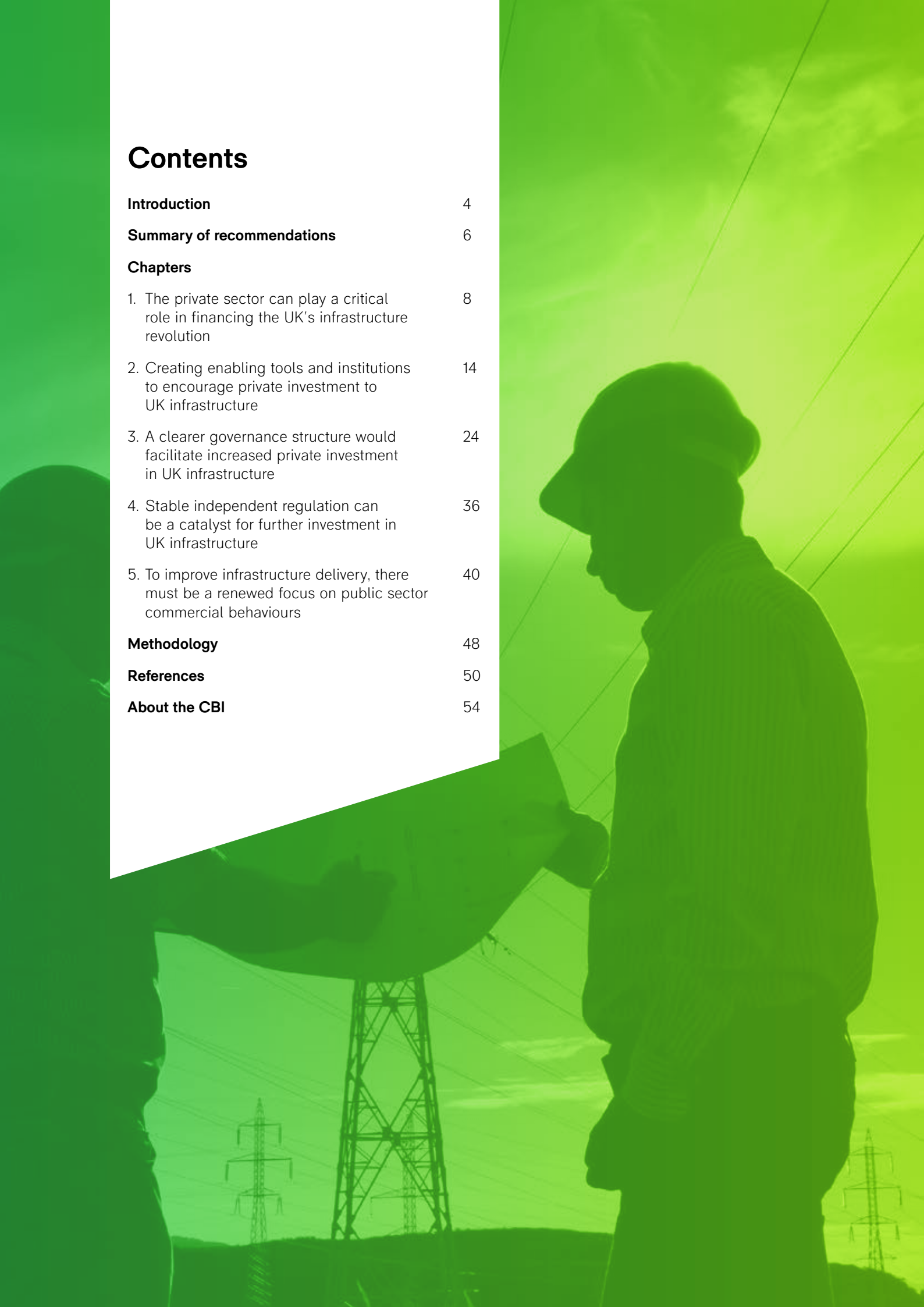
## Sourcing the finance to build back better

September 2020

Infrastructure and Energy

# Contents





# Introduction

Infrastructure is a key enabler of economic growth, and in the aftermath of Covid-19, it will play an important role in the UK's economic recovery. Focusing on infrastructure delivery will help stimulate the renewal of the UK's economy, and transition it to a fairer, more sustainable economy. Infrastructure not only attracts investment and supports employment across all of the UK's regions and nations, but it is also an economic multiplier, particularly through its role in supporting the UK's construction sector. Previous CBI research shows that for every £1 spent on construction activity, £2.92 is created in wider value to the economy.[1]

Furthermore, evidence shows that when 1% of GDP is invested in infrastructure, economic output increases by approximately 0.4% in the same year, followed by a 1.5% increase four years later.[2] The delivery of new infrastructure will also play a key role in supporting a green recovery, and progressing towards meeting the UK's target of net-zero greenhouse gas emissions by 2050, as modern networks and new methods of construction help cut emissions.[3] The International Renewable Energy Agency has suggested that financing green growth could stimulate global GDP gains of $100 trillion by 2050, while quadrupling the number of jobs in the sector to 42 million.[4] Furthermore, this would help reduce the energy industry's CO2 emissions by 70%.[5] But, if UK is to seize these opportunities and meet its climate ambitions, it will need to undertake a significant programme of infrastructure investment.

Prior to the outbreak of Covid-19, businesses welcomed the government's commitment to deliver an *"infrastructure revolution for this country."*[6] This commitment was supported by its March 2020 Budget, which included a historic pledge to spend over £600 billion in the next five years on infrastructure.[7] Businesses saw this announcement as a watershed moment for the country and interpreted it as a clear sign that the government was serious about delivering on its 'levelling up' agenda.

However, the sudden onset of the Covid-19 crisis placed a significant and immediate burden on the UK's economy and public finances. The shutdown of large parts of the economy resulted in a sharp contraction in economic activity in April, with only a partial recovery seen in May and June, and the economy is still around 17% smaller than it was in February.[8] To protect jobs and livelihoods from the impact of the pandemic, the government introduced an unprecedented set of support measures for the economy, estimated to cost over £300 billion so far.[9] According to the Office for Budget Responsibility's latest economic and fiscal scenarios, the government's policy response, coupled with a downturn in economic activity, is estimated to result in a £372 billion deficit in 2020-21, the equivalent of 18% of GDP and the highest deficit in over 300 years (excluding periods of war).[10, 11]

As a response to the economic downturn created by the Covid-19 pandemic, the UK Prime Minister, Boris Johnson, reiterated the government's commitment to driving infrastructure delivery.[12] The UK's approach is consistent with our international partners, as it has been reported that countries are planning to increase infrastructure investment to levels not seen since the post-2008 financial crisis stimulus measures.[13] While the UK government's commitment to delivering infrastructure remains undeterred, it is important to note that the country's fiscal position has substantially worsened as a result of the Covid-19 crisis. In this context, the private sector has a key role to play in helping to bridge the funding gap needed to deliver the government's infrastructure vision. Indeed, the World Economic Forum has noted that the world faces a $15 trillion (approx. £12 trillion) gap between the infrastructure investment needed and the amount provided by 2040.[14, 15]

While businesses welcome this commitment to infrastructure delivery in the UK and across the world, the scale of the finance required highlights the critical role that private sector investment will have to play if this gap is to be filled, and if the UK government is to successfully implement its ambitious infrastructure agenda.

Anecdotally, businesses have suggested there is no material reduction in the level of private sector capital available to fund infrastructure. This capital primarily takes the form of pension funds and insurance institutional investments, which are focused on long-term, stable infrastructure income. The UK is currently experiencing historically low interest rates, making financing more attractive. Yet, despite this strong desire from both the government and business, there remain challenges to overcome.

While current investor appetite for infrastructure is high, factors such as cumulative prudential regulation, and a lack of clarity on the pipeline of upcoming projects requiring private investment may have a negative effect on an investors' appetite to invest in the coming years. Achieving government policy objectives, such as reaching net-zero and rolling out full-fibre and other gigabit technologies, will require transformative investment in economically regulated industries including energy, transport, water, and telecommunications. For the planned investment to be forthcoming, and as the UK emerges from the Covid-19 crisis, it needs to develop a world-class environment for private investment in infrastructure.

Within this context, this paper sets out businesses' views on private sector investment in the UK's infrastructure. It draws on the expertise and experience of CBI members from across the infrastructure market, including investors, developers, engineers, and consultants. It suggests steps the government should take to increase private sector investment to ensure the UK's infrastructure meets the social and economic needs of the country as we build back better from the Covid-19 crisis.

# Summary of recommendations

1. Government should regularly publish data highlighting the use of private finance across the UK's infrastructure market, including information on project performance.
2. With the end of the Brexit transition period, and the likely conclusion of the UK's access to the European Investment Bank, the government should create an infrastructure bank, which could form part of a larger investment institution to support the UK's economic recovery.
3. The government should require the Infrastructure and Projects Authority to act as a conduit to coordinate the existing investor relations functions that exist in other government departments.
4. The government should give greater operational independence to the National Infrastructure Commission and the IPA, so they are empowered to hold the government to account on infrastructure delivery.
5. The new operationally independent IPA should drive greater alignment across government departments responsible for infrastructure delivery and provide these bodies with increased on-the-shoulder support to improve project outcomes.
6. The government should use the National Infrastructure and Construction Pipeline to outline which infrastructure projects it is seeking private finance for, and the private finance delivery model that will be utilised in each case.
7. The government should require regulators to have specific regard to deliver the National Infrastructure Strategy, including progressing towards meeting the net-zero emissions target for 2050. Each regulator must have a clear responsibility to acknowledge how regulatory policy aligns with the government's strategic objectives on infrastructure investment, including its net-zero emissions target for 2050. This would also require each regulated sector to assist regulatory decisions and reduce fragmentation between departments and regulatory bodies.
8. The government should launch a call for evidence on the broader tools available to achieve its long-term investment ambitions.
9. Regulators should expand their toolkit beyond price controls. The use of price controls can lead to underinvestment given their short-term nature. Regulators must explore better complementary alternatives to deliver the transformative investment required.

10. The government should embed the principles on risk allocation in the Cabinet Office's Outsourcing Playbook across built environment contracts.
11. Public and private sector clients should be required to make a credible and consistent assessment of balance sheet strength during the first stage of a procurement process.
12. As the government's centre of expertise for major projects, the IPA should develop a set of principles and accompanying guidance to support all central government departments in bringing forward market-led proposals for delivering major public sector projects.
13. The government should ensure that public contracts incentivise businesses, involved in building and operating infrastructure, to meet long-term objectives, as well as short-term delivery goals.

# The private sector can play a critical role in financing the UK's infrastructure revolution

The UK's infrastructure finance market is globally renowned with numerous strengths including historically strong legal and regulatory frameworks and an experienced pool of talent, expertise, and innovation. London is a global centre for infrastructure finance, as investors from Europe, and beyond, gravitate there to conduct financial transactions. Historically, a significant level of liquidity and a welcoming attitude to foreign investment has enabled the UK to attract private finance.

In addition, the UK's infrastructure finance market benefits from significant levels of expertise and experience provided from investors, contractors, and infrastructure providers, which gives it a uniquely strong position against international competitors.[16] This enables the UK infrastructure market to contain different pools of capital, providing additional flexibility and tailored solutions for different infrastructure asset classes.[17]

As a result, the UK compares well against other countries in its ability to attract private finance to its infrastructure, which has contributed to the perception of the UK as an attractive destination for international investors.[18] The UK's diverse brownfield assets are also a strength, providing a critical mass of opportunity for private investors which is not necessarily available in other countries.

In recent years, however, businesses have suggested that the combination of the UK's regulatory approach and the threat of re-nationalisation have highlighted the extent to which the UK's infrastructure finance market is susceptible to changes in the political environment, and this has undermined the case for private investment. On regulation for example, the Prudential Regulation Authority's work on the prudential framework for insurance Solvency II were initially cited as a barrier by private investors to the free flow of capital, though this has subsequently been reformed. Some businesses have also developed the perception that there is a lack of political support in relation to private finance for new infrastructure schemes. A welcoming political environment alongside stable policy frameworks are essential to help maximise the private sector's participation in UK infrastructure, as infrastructure projects do not operate in line with political cycles.

**The private sector offers additional benefits that can serve effective infrastructure delivery in the UK**

The delivery of infrastructure is a significant undertaking, with many costly and lengthy stages required before a concept becomes reality. While not every private finance project is successful, businesses remain confident that they can bring additional capacity, skills, and expertise to the financing and delivery of infrastructure.

The private sector brings a different form of governance that is often more agile, and longer term in its outlook. This includes, for example, targeting investments that achieve environmental, social and governance (ESG) objectives through green bonds or carbon disclosures. Many individuals in the private sector also bring significant expertise to the infrastructure market and have a broad and longstanding experience of implementing infrastructure finance across a number of jurisdictions.

The private sector is well-equipped to finance and build infrastructure on time and on budget, and manage the design and construction risks throughout the duration of an infrastructure project. For example, according to Infrastructure Ontario, of the 30 projects delivered with private finance since 2007, 29 were completed below budget and 22 were opened on time.[19, 20] In addition, the Thames Tideway Tunnel project was financed using an innovative RAB model, which resulted in a lower cost of capital and an increase in consumer bills of £13 – £25 per year, considerably lower than the original estimates of £70 – £80 per year.[21]

Within the rail sector, the Hansford Review concluded that third party investment would attract additional funding, and bring a competitive pressure to reduce costs, benefitting both the government and the consumer.[22] The review also found that a more contestable market would encourage the government, and its supply chain, to be more innovative, improve cost performance, deliver projects competitively and offer better value for money.

In contrast, it is not unusual for government-procured projects to run over budget, over time, and deliver infrastructure that does not live up to the operational capability that was originally envisioned. For example, the National Audit Office's (NAO) assessment of the programme to modernise the UK's Great Western Railway, found that delays to the electrification of the route, which were estimated to last between 18 and 36 months, were projected to cost the Department of Transport up to £330 million.[23] This is just one of a number of projects found not to be delivering value for money by the NAO.[24]

The private sector enjoys a continuity of procuring infrastructure projects that the public sector may not have. For example, it can retain expertise within its organisation and move from one infrastructure project to the next, whereas the public sector may, upon conclusion of a project and beginning of another, have to assemble a new procurement and delivery team from scratch.[25] This was noted in the Institute for Government's (IfG) report, 'Moving On, The costs of high staff turnover in the civil service'. The IfG argued that among commercial, operational delivery and policy roles within the civil service, staff turnover is *"consistently at an excessive level."*[26] The report also notes that this rate of staff turnover compares poorly with other civil services around the world and equivalent private sector organisations.[27]

Where the private sector is involved throughout a project, from conception to delivery, businesses are able to implement a fully integrated approach, with the design and construction of the project based on a long-term view focused on efficient life cycle costs. A study conducted by Intervistas Consulting identified cost savings of $9.9 billion from 121 value for money assessments undertaken on Public-Private Partnership projects by provincial governments in Canada over a 10-year period to 2012.[28] Cost savings driven by project and technology innovation in the UK's offshore wind sector have also resulted in dramatic falls to the costs of future Contracts for Difference contracts. The 2019 auction results were around 30% lower than the previous auction held in 2017.[29] Ultimately, the consumer benefited in the form of lower bills.

Finally, the private sector also offers additional liquidity, with significant demand for long term investments. Businesses have observed that the sterling market is dominated by long term investors, such as insurers, that are looking to invest in long term, investment-grade assets such as infrastructure.

To support its ambitious infrastructure agenda, and provide better connectivity at good value for taxpayers, the government must reinvigorate the market for Public-Private-Partnerships. It must commit to an approach that capitalises on the attributes of businesses and public sector establishing itself once again as a world-class destination for investment.

### A renewed effort to publicise the benefits of private finance and investment in UK infrastructure is necessary to help restore confidence in the market

The private sector's mandate for operating in infrastructure has been weakened in recent years, as the benefits of business involvement have been overlooked. This is despite the fact that there are many examples of private contracts in infrastructure which have delivered fair returns for all parties, and beneficial outcomes for society.

### Case study: BT Group's £12 billion investment in full-fibre broadband[30]

BT recently announced a £12 billion investment to support Openreach's deployment of full-fibre broadband. Openreach has the ambition to pass 20 million premises, across the UK, with full-fibre broadband by the mid to late 2020s, and recently set out plans to build full-fibre networks to over 3 million of the hardest to reach premises in the UK. Full-fibre will deliver significantly improved reliability and gigabit speeds, and will have transformational outcomes for the UK's economy and society.[31] The Centre for Economics and Business Research estimated that the benefits to UK productivity could reach £59 billion, and could bring up to 500,000 people back into the workforce. The benefits of full-fibre will be felt in communities across the country and will provide the foundations for growth, business creation and the travel and working behaviours that will support our response to climate change in both urban and rural areas, helping to level-up the UK.

### Case study: Virgin Media's investment in gigabit-capable networks is improving remote diagnostics[32]

Diagnostics-quality video streaming and sharing allows remote consultations, where patients and/or doctors carry out consultations from their homes. An example of this application, which has already been implemented, is the Telestroke Network in the UK which is a collaboration between Virgin Media and the NHS. This network enables hospitals to offer out-of-hours remote stroke diagnosis (where it previously did not) in Cumbria and Lancashire. Virgin Media is also investing to upgrade its entire network to gigabit speeds by the end of 2021. The availability of gigabit connections at home will mean that remote diagnosis could be offered, not only by specialists who are working in remote hospitals, but also by out-of-hours specialists, resulting in increased speed of access to treatment and improved patient outcomes.

However, when infrastructure projects encounter issues or delays, they are widely publicised, resulting in a damaging public perception of the private sector's involvement in all parts of the infrastructure value chain. To tackle this, businesses recognise that they have an important role to play in engaging with the public to promote the social benefits of their impact on society through delivering infrastructure. Increased efforts to undertake social impact assessments of key infrastructure projects, such as the recent work carried out by Skanska and Costain on the HS2 Enabling Ground Works project, which found £115.5 million of social and local value added is one way this can be achieved.[33] This is a necessary step to strengthen the private sector's mandate to operate in infrastructure.

However, rebuilding public trust in private finance is not something that industry can do alone. Businesses would therefore like to see a joint effort with government to promote the benefits and expertise the private sector brings to UK infrastructure.

Increased dialogue should also be coupled with increased transparency around the role that private finance plays in delivering infrastructure projects. Government should therefore consider the regular publication of the use of private finance in key infrastructure projects, including information on their performance and delivery. This information would be useful for both investors and the public.

This could take the form of an HM Treasury and IPA-led private finance infrastructure taskforce, with participation from industry. This would create a forum for the public and private sector to discuss how best to highlight the merits of private capital and the expertise, improvements, and efficiencies it brings to infrastructure assets. In addition, it would create an opportunity for businesses to highlight and promote projects, under construction, that are going to plan, and those which are delivered on, or ahead, of time and budget.

**Recommendation**

- Government should regularly publish data highlighting the use of private finance across the UK's infrastructure market, including information on project performance.


*“Rebuilding public trust in private finance is not something that industry can do alone.”*

# Creating enabling tools and institutions to encourage private investment to UK infrastructure

The UK infrastructure finance market is strong. However, there remain steps that can be taken to make it more attractive to a wider pool of investors. This should begin with government establishing the right institutions and governance structures combined with the development of the right tools to improve investor confidence.

### Government should take steps to improve business confidence in the National Infrastructure and Construction Pipeline

The National Infrastructure and Construction Pipeline is an important publication detailing the UK's planned infrastructure investment for forthcoming years.[34] The pipeline is comprised of projects and other spending commitments that have been announced. The 2018 pipeline set out over £400 billion of planned investment, of which around £190 billion was projected to occur by 2020/21.[35] It has the potential to be a useful resource for businesses across the value chain that are interested in playing a role in financing, developing or operating infrastructure. However, businesses want to see some specific improvements in the pipeline to make good on this potential and build confidence in the market.

The majority of the projects listed within the pipeline appear to be for public investment or are to be delivered by regulated utilities and therefore, little insight and opportunity for involvement is given to private investors. The current pipeline is seen by many firms as too large, unpredictable, complex, and lacking certainty, with the information it contains being frequently mis-interpreted and lacking prioritisation. Businesses have also noted that the information contained within the pipeline does not indicate where or how private finance can be used to deliver the projects.

The pipeline is also often outdated, which is indicative of a system that acts as a high-level aggregation of potential projects, as opposed to providing specific information highlighting where investors can participate. Furthermore, many of the current projects listed in the pipeline are not economically viable to a significant number of infrastructure investors, raising the concern that the current pipeline is intended to act as a document highlighting political aspiration for infrastructure delivery, rather than a genuine mechanism for signposting investment opportunities.

Private sector capital will only be released for investments in projects which are considered to be bankable against the relevant equity investor or lending institutions' set of internal requirements. Given there is no shortage of liquidity in the market for infrastructure projects in the international market that have a bankable risk allocation, government should look to ensure more projects on the pipeline meet these criteria.[36]

**Internationally, businesses have cited examples of governments effectively using a pipeline to signal that their infrastructure is open to private investment and finance**

### Case study: The Brazilian Infrastructure Pipeline's monthly updates gives investors close to real-time information to help secure their backing

The Brazilian government has embarked on an aggressive infrastructure investment plan, adapting their infrastructure pipeline, which is designed to attract foreign investment and private participation in their infrastructure market.[37] The Brazilian government publishes, every month, in English, a traffic light coding of all the major projects in development. This initiative publishes the details of the stages of each programme, from conception to funding. The programme also obligates the relevant government department to provide a monthly update on whether the project is running to schedule or not.[38]

### Case study: Infrastructure Australia's pipeline is designed to be 'user-friendly', containing information that is readily accessible for investors[39]

Infrastructure Australia's pipeline is designed to be user-friendly, with its information being easily accessible. The Infrastructure Forum's submission to the government's Infrastructure Finance Review, *New Measures to Boost Investment*', notes that the pipeline distinguishes between 'initiatives', which are potential projects which do not yet have a completed business case, and 'projects' which have a business case and approval from the Infrastructure Australia board.[40]

The Infrastructure Forum highlighted the Australian pipeline as a model of best practice, and it was also noted by a number of businesses during the consultation process for this paper.[41]

### Case study: All infrastructure projects in the Netherlands have had to go through a 'market scan' stage, where suitability for private sector involvement was considered

All transport projects, which were expected to cost more than 60million Euros, were considered for a Public Private Partnership (PPP). The Dutch PPP pipeline consisted of those projects at a preparatory stage, and those being prepared for tender. The government also set out the details of upcoming projects in a deal flow document, including the estimated capex for the project, objectives and expected year of financial close. Evidence suggested that the procurement process was timely and streamlined, with a target of 16 weeks from the bid deadline to financial close. This approach made for a more predictable and attractive proposition for investors to bid into.

**Case study: Infrastructure Ontario produces four updates throughout the year, containing clear and reliable information on projects' scope and size**

There are also aspects of the Canadian model that the UK could draw on. For example, Infrastructure Ontario's pipeline includes four updates throughout the year (two major updates and two minor updates). Businesses have noted that the information within the Ontarian pipeline is clear, containing detail on the available projects to participate in, with information on their scope and size being reliable.

Besides the Ontario Model, different provinces in Canada proactively take steps to inform the market of the new investment opportunities. This includes a structure to interact with potential investors, and adapting the projects based on the feedback received. In general, businesses have suggested that the Canadian market is predictable, and its experience in engaging with the private sector leads to sophisticated projects and procurements, such as the extension of existing projects with incumbent parties, and the structuring of complex initiatives including the Metrolinx GO Regional Express Rail Package 3 project. Industry would like to see this level of detail applied to the UK's National Infrastructure and Construction pipeline.

**Case study: The Sustainable Infrastructure Foundation's 'SOURCE' initiative is a multi-lateral platform providing a digital map covering all aspects of infrastructure projects**

This includes governance, economic, legal, financial, environmental, and social issues. The platform uses sector-specific questions covering all the stages of the project cycle, spanning from project definition to operation and maintenance.[42] This level of detail provides businesses with a clear overview of the viability of infrastructure projects, incentivising them to take part and contribute to the financing of them.

The government should look to these international examples, and others, when considering how to improve the UK's National Infrastructure and Construction pipeline. More specifically, businesses have suggested the following steps to increase the private sector's confidence in the infrastructure pipeline:

- *Provide greater prioritisation in the pipeline* – the government should outline a priority list of twenty top projects, where there is a clear opportunity for private sector investment. This would enable investors to determine where to focus their efforts.
- *Provide clear signals that a project is being proactively driven forward and provide timely updates* – these signals provide assurances to potential investors that the projects listed within the pipeline have the political will behind them to see them through to delivery. Projects in the pipeline should contain a government commitment to deliver and technology should be embraced in this space, ensuring that it can function as a live document, updated in real-time.
- *Take a programme approach* – building on reforms to the pipeline, the government should consider aggregating smaller projects with a similar risk profile as part of an overarching programme of projects, rather than a series of individual ones. This would make them more attractive for investment as there is a sustainable pipeline of infrastructure projects that allows for a coherent, long-term investment strategy.
- *Ensure projects are 'bankable'* – investors are unlikely to commit funds to a project unless it is 'bankable' and 'investment ready', meaning that before committing resources, there needs to be evidence of a project's feasibility. A project's feasibility, in this context, is not just measured in financial terms, but also in terms of social, economic, technical, environmental, and administrative factors. There should also be a clear sense of the project's purpose and objectives as well as sensible or appropriate risk allocation to ensure investors understand a project's viability. The way a project is structured can also affect its 'bankability'. Before a project is brought to market by government, future projects should also have the following pre-requisites:
    - public support
    - a clear purpose for the project with an economic case supporting it
    - an identified funding model and revenue stream
    - the correct scale and scope for investment and delivery i.e. between £500 million to £1 billion in size
    - political support from the Minister responsible for the type of infrastructure being delivered
    - a government department that takes sole ownership and responsibility of the project

- *Shortening timescales* – Projects often take too long to come to market, which lessens the interests of those wanting to invest. These delays add further costs, which are often not recouped, and risks to the project. To tackle this, the government should aim to set shorter and clearer timescales for scoping project proposals and approving them.

Taken together these steps would help make the UK's National Infrastructure and Construction pipeline a more attractive tool to investors.

### Should the United Kingdom withdraw its participation from the European Investment Bank (EIB), the government should establish an enabling institutional framework to mitigate against the potential loss of EIB funding

Businesses view the European Investment Bank (EIB) as a useful institution, facilitating international participation in the UK infrastructure finance market, and decreasing risk to investors.[43] The EIB provides cheap debt on infrastructure projects facilitating involvement from equity investors. In addition, businesses have credited the EIB with providing early finance in markets where little capital exists. For example, the role the EIB plays in providing early finance in emerging markets or cutting-edge projects, allows confidence to grow for potential investors, and enables investment in innovative technologies and sectors.

#### Case study: The European Investment Bank and offshore wind

The EIB played a key role in stimulating investment and delivery of offshore wind, helping to increase offshore wind's contribution to the UK energy mix eight-fold between 2010 and 2017.[44] From the perspective of the UK government, the creation of the Green Investment Bank created a source of funding to invest in emerging technology. Businesses commend the government for having simultaneously created an investment mechanism through the renewable auctions process (Contracts for Difference) which boosted buying capacity under a competitive market for wind power.

These concrete government actions constituted a long-term commitment to the technology, which signalled to the private sector that offshore wind was worth investing in. The result was that in the space of approximately ten years, the wind sector went from being considered as not financially viable for investment from the private sector, to a completely privately-funded sector: indeed, offshore wind in the UK is now the cheapest form of renewable power generation. In this instance, government support created the market conditions necessary to enable private sector investment in an emerging technology, creating long-term efficiency.

Businesses have suggested that emerging technologies will likely experience funding issues due to the associated risk of entering a new market, and the barriers to entry linked to technology costs. However, businesses note such projects can become more economically viable upon reaching a more advanced stage. These areas will require significant sums of capital to finance and would need initial government support to encourage private investment. However, over the longer term, this would reduce the UK's carbon footprint and increase its energy security. While the UK should not be closed to different lenders, business have suggested an institution of a similar nature to the EIB can help drive early investment into emerging technologies.

Currently, the EIB's role in the UK extends far more widely than its role in direct lending to support infrastructure projects. This has included lending to SMEs, utility companies and universities. Furthermore, the EIB has helped resolve affordability issues across numerous contracts, facilitating the sharing of costs fairly between funders and sponsors. The EIB also plays an important role in solving complicated contracts to enable smooth transactions and as a standard-setting body in contract behaviours.

Without a replacement for the EIB, funding cutting edge infrastructure priorities such as those in energy generation, power transmission, fibre networks and broader environmental infrastructure could be more difficult. The removal of EIB funding, without a replacement, will also have an impact on infrastructure projects through the financial position of the supply chain and levels of investment in research and development.

Should the UK conclude its participation with the EIB, it has been reported that plans are being formulated to create a British Infrastructure Bank to replace it. It has also been suggested, however, that establishing such a body could take several years. In the 2018 National Infrastructure Assessment, the National Infrastructure Commission recommended that, if UK loses access to the EIB then a new, operationally independent UK Infrastructure Finance Institution should be established by 2021.

It is therefore welcome that the government's Infrastructure Finance Review consultation highlighted that the UK is *"actively exploring options for a future relationship with the EIB Group. The UK will explore these options with the EU as part of the broader negotiations on the future relationship between the UK and the EU."*[45] It is important to note that on certain social infrastructure projects, the EIB's involvement was ultimately unnecessary due to there already being significant capital available. Businesses have also suggested that the EIB can sometimes act as a politically driven body, focusing on increasing connectivity within the European Union, and not always on delivering efficiency and maximum value for money.

**In the event that the UK concludes its participation with the European Investment Bank, to enable private sector investment in UK infrastructure, the creation of a UK infrastructure bank should be considered, which could form part of a larger investment institution**

The 2018 National Infrastructure Assessment made the case for a new Infrastructure Finance Institution to be established should the UK no longer have access to EIB funds. More recently, this idea has gathered momentum with stakeholders in the public and private sector, getting behind the creation of a new infrastructure bank. Businesses back the idea for two primary reasons. Firstly, an infrastructure bank would provide comfort to lenders and institutional investors on the viability of an infrastructure project, and the role of the public authority that tenders the project. Secondly, an infrastructure bank may reduce the risk to be allocated among private lenders and therefore reduce financing costs.

Businesses have suggested it would be sensible for a future infrastructure bank to impose credit-worthiness requirements to obtain financing from it. This would mitigate against high-risk profile infrastructure companies benefitting from competitive financing. For example, the United States of America's 'Transportation Infrastructure Finance and Innovation Act' contains credit rating requirements to access finance.

Regardless, any business case for the establishment of a 'UK Infrastructure Bank', on its own or as a function within a larger institution, will need to determine whether it is seeking to broadly mirror the role that is currently performed by the EIB or to have a wider remit. If limited to replicating the role of EIB, then the value for money of creating such an institution would need to be considered. The costs associated with establishing and running a dedicated UK Infrastructure Bank are likely to be significant when compared to the quantum of lending that the EIB currently provides to the UK infrastructure market. Government should therefore consider a wider scope to promote investment as the UK deals with the fall out of the Covid-19 crisis and plans for a post-Brexit future. Any National Investment Bank should have a clear infrastructure remit.

Such an institution would be anticipated to be 'on balance sheet' for the UK government. In addition, the governance arrangements for any UK Infrastructure Bank would need to be carefully designed to establish its objectives and required level of autonomy for it to operate on an arms-length basis, and to take apolitical decisions.

If the government decides to develop an infrastructure bank, it should formulate the bank's remit and scope in consultation with businesses, to help ensure that it is effective at attracting private sector investment and financing into the UK's infrastructure market.

**Recommendation**

- With the end of the Brexit transition period, and the likely conclusion of the UK's access to the European Investment Bank, the government should create an infrastructure bank, which could form part of a larger investment institution to support the UK's economic recovery.

### A UK infrastructure bank should be focused on crowding in private finance by reducing risks, promoting market stability, and increasing investor confidence

Businesses have suggested that a UK Infrastructure Bank (or equivalent organisation) may offer greater value for money if it became a conduit for deploying wider measures that constitute UK government support for infrastructure. This could include overseeing arrangements in respect of grants, guarantees and subsidies, alongside lending which does not displace the private sector. Any such arrangement would require a new institution to have clarity over its budgetary position (on the assumption that the measures will be incapable of being self-financing) and governance arrangements.

Businesses would like a new infrastructure bank to provide the market with the long-term confidence that comes with the government's commitment to investment in infrastructure. This commitment could take the form of systematic support on projects with investments conducted on a co-lending basis, with the minority of capital coming from the newly created bank, and the majority coming from the private sector.

A new infrastructure bank should also be created with the intention of enabling the finance required to reach net-zero and decarbonise the economy. To do this, the institution would need to be outcome-focused, with clear sectoral goals that it aims to support, such as financing low-carbon power generation, retrofitting buildings, or delivering electric vehicle charging infrastructure. It could also play a role in de-risking projects that are either new or innovative, which could prove a barrier to some low-carbon investments in the future.

The bank's main functions could consist of direct lending or providing guarantees, as is currently provided by the Infrastructure & Projects Authority (either full wrapped guarantees or first loss guarantees). Direct lending optimises financing costs and provides value for money to the public sector and guarantees give comfort to lenders to invest in different stages of the project. For example, some lenders may not be comfortable assuming construction risk, but a partial guarantee from an infrastructure bank might be the variable that gives lenders enough comfort to invest at an early stage, enticing more lenders to the financing, and therefore, making the process even more competitive, providing value for money to the public bodies.

This is a similar role to the Canadian Infrastructure Bank (CIB) which enables the Canadian government to explore projects that would otherwise be difficult to bring to the market. In Canada, there is sufficient liquidity to finance many of their planned infrastructure projects. Therefore, there was an initial fear that the CIB would crowd-out the financing community.

However, in practice the CIB assists the market as a vehicle to present innovative and unsolicited proposals, to help the client manage risks that the private sector cannot accept (through providing separate financing). Businesses have suggested that the CIB can also provide competitive financing when a project is too large for the market. Consequently, it is seen as a vehicle to bridge a gap between the public and private sector in complex initiatives that require innovative solutions. Businesses have noted that the CIB, ultimately, helps make projects more competitive, bringing projects to the table that otherwise could not be structured.

Finally, it is also essential that a UK infrastructure bank works closely with regulators, such as the Prudential Regulation Authority, to ensure that the right enabling framework is created. This will be critical to promote stability and investment and increase private sector confidence.

**Case study: Transportation Infrastructure Finance and Innovation Act (TIFIA) is a government loan facility which aims to stimulate capital market investment in transportation infrastructure projects in the United States of America**

One of the key objectives of TIFIA is to be a flexible, 'patient' investor willing to take on investor concerns about investment horizon, liquidity, predictability, and risk. This loan facility is primarily limited to 33% percent of the anticipated eligible project costs and requires the project debt (both TIFIA and senior debt) to receive investment grade ratings from at least two nationally recognised credit rating agencies.

To be eligible for this program, the project must have a dedicated revenue source pledge to secure both the TIFIA and senior debt financing. Additionally, the applicants must submit detailed letters of interest when a project is able to provide sufficient information to satisfy statutory eligibility requirements, such as creditworthiness and readiness to proceed. Furthermore, to obtain an invitation from the TIFIA Joint Program Office, a formal application is required. The applicants can be state governments, local governments, special authorities, and private firms. Project sponsors must reimburse transport departments for the costs of the external advisors who advise TIFIA on the transaction.

**Case study: The Green Investment Bank (GIB) has been identified as a useful model, demonstrating how a national infrastructure bank can work and operate**

The Green Investment Bank was able to invest in technologies, which at the time were emerging, and which required support. The government was able to use the GIB to develop a centre of expertise in green energy financing when it sold the GIB to Macquarie in 2017.

**Case study: Private Activity Bonds (PABs) are debt instruments authorised by the US Secretary of Transportation, and issued by a conduit issuer, on behalf of a private entity for highway and freight transfer projects**

These instruments allow a private project sponsor to benefit from the lower financing costs of tax-exempt municipal bonds. Passage of the private activity bond legislation reflects the Federal Government's desire to increase private sector investment in the United States transportation infrastructure. PABs provide private developers and operators with access to tax-exempt interest rates, lowering the cost of capital significantly and enhancing investment prospects. As of April 7, 2020, approximately $12.12 billion in PABs have been issued.

# A clearer governance structure would facilitate increased private investment in UK infrastructure

Improving governance structures in the UK Infrastructure market and increasing clarity around decision-making are two priorities for businesses operating in the infrastructure finance market. Clearer lines of accountability and better cross-government collaboration would help create more confidence and favourable conditions and allow for greater investment in projects. This needs to be coupled with a supportive financial regulatory environment, which is considered in detail later in this paper.

### Government should ensure it has the structures in place to effectively engage with international investors

Straightforward and supportive governance, with clear ownership, would help lower the risk rating of infrastructure assets for financers. Currently, there can be too many regulatory entities involved in the developing of infrastructure projects. This can make it complex for investors to engage with the UK's infrastructure market.

The Department for International Trade (DIT), through its Capital Investment & Entrepreneurship Directorate, engages regularly with international investors on infrastructure and real estate investment opportunities, acting as an investor relations function to garner views on the competitiveness of the UK and to listen to policy or regulatory concerns. The Department's engagement with the infrastructure investment community has increased significantly since the position of Minister for Investment, was recently created.

Other government departments, such as HM Treasury, have specific sector teams focused on issues impacting investors, and this investor engagement is complemented by the regulators own investor relations functions, such as Ofgem's.

However, feedback from businesses across the infrastructure sector suggests that further steps should be taken to strengthen government engagement with infrastructure investors. In particular, the Infrastructure & Projects Authority (IPA) should set out a clear industry engagement structure for UK infrastructure across all relevant departments and agencies, including key regulators. Knowing who the decision-maker is at different points in the process will allow the private sector to engage and support the relevant department during the development of projects. Raising challenges efficiently will also help to avoid obstructions.

In this context, the IPA should act as a stronger conduit between private sector investors, and the relevant government departments involved in facilitating infrastructure finance and investment.

**Recommendation**

- The government should require the IPA to act as a conduit to coordinate the existing investor relations functions that exist in other government departments.

Implementing this recommendation would enable the IPA to sign-post private sector investors to the relevant government investor relations functions. This would serve two purposes: a regular and informed 'pulse check' of the investing environment and sentiment to the government, and timely feedback to the investment community on the status of the UK infrastructure market.

Greater transparency from government could also lead to increased accessibility of data and information. In turn, this could help encourage best practise to be shared across relevant departments or authorities.

### Giving the NIC and IPA greater independence, would enable them to hold government to account on infrastructure delivery

Currently, the IPA is seen as a useful centre of infrastructure delivery expertise, however its position under both the Treasury and the Cabinet Office can be problematic.

An operationally independent IPA could utilise its expertise to support local authorities in infrastructure commissioning, where expertise is considered to be scarce. Additionally, an independent IPA could better support key government departments, as currently a number of industry experts sitting across numerous government departments has led to a fragmentation of standards for similar types of projects.

The current governance structure can also lead to a disconnect between the relevant sponsoring government agency, regulator, IPA, and the views of the National Infrastructure Commission (NIC) in terms of the long-term strategic requirement. This disconnect has been identified as a reason for the perceived slow development of new models for investment in areas such as interconnectors, Direct Procurement for Customers in water, onshore transmission, electric vehicle charging strategy and market-based proposals for rail.

Businesses have also identified the NIC as a very important body, providing strategic direction on infrastructure delivery. However, businesses note that the NIC is also not independent, limiting its ability to hold the government to account on infrastructure delivery.

**Recommendation**

- The government should give greater operational independence to the NIC and the IPA, so they are empowered to hold the government to account on infrastructure delivery.

Businesses have suggested that there should be increased alignment across government departments in the way they approach infrastructure delivery, with a view to driving efficiency. This should include departments taking a more consistent approach to project delivery and how they work with the supplier market.

Currently, the IPA often provides support at the beginning of projects, including helping to assess whether a project is likely to be viable and deliver good value for money. While this is welcome progress, business would like to see this extended further, with an increased focus on providing on-the-shoulder support for departments. Business believes this can not only reduce delays and disruption but help improve the overall effectiveness of infrastructure delivery.

**Recommendation**

- The new operationally independent IPA should drive greater alignment across government departments responsible for infrastructure delivery and provide these bodies with increased on-the-shoulder support to improve project outcomes.

### The government's decision to discontinue PFI/PF2, with no replacement model proposed, has created uncertainty about its appetite to increase private investment in UK infrastructure

Businesses suggested that the government's decision to discontinue PFI/PF2 as an investment model has created uncertainty, with investors questioning the government's appetite to partner with private investors in financing UK infrastructure, and the viability of live PF2 infrastructure projects.

Businesses acknowledge the government's assertion that it will not seek a like for like replacement for PFI/PF2 and recognises the shortcomings of the PFI/PF2 models, including the potential for higher costs to be placed on the taxpayer and their operational inflexibility, if the model is applied poorly.[46, 47]

Nevertheless, businesses note that while PFI/PF2 attracted criticism, the model was considered to be a sound delivery mechanism, when managed correctly, and that PFI/PF2 continues to be used today, with success, in countries such as the Netherlands, Norway and Australia. For example, Infrastructure Partnerships Australia's recent analysis of the performance of social infrastructure Public-Private Partnerships (PPPs) concluded that PPPs are delivering substantial benefits to the providers and users of schools, hospitals, prisons, and other types of social infrastructure.[48] With no replacement for PFI/PF2 announced in over a year, nor indeed a clear strategy for attracting private finance across a broad range of infrastructure assets, it is now vital that the government looks at new ways to support the facilitation of private finance into UK infrastructure. This will not only support investors to put economic infrastructure at the heart of their business's long-term strategy but will ultimately benefit consumers through the expertise and capital which investors can bring to improve the performance of assets.

### The government should set out its approach for utilising different models to attract finance for different types of infrastructure

The government's Infrastructure Finance Review set out examples of the numerous private finance delivery models government and independent regulators use to facilitate private investment in UK infrastructure. In addition, the review document outlined which models are frequently used in relevant sectors, including water, energy, airports and digital. The review emphasised that the government *"continues to support a wide range of vehicles for delivering private investment into consumer-funded infrastructure."*[49]

The government's commitment to supporting a wide range of vehicles for delivering private investment into UK infrastructure is welcomed by businesses. Different private finance delivery models are suited to different sectors and projects, and therefore would not advocate the government's potential championing of a single private finance delivery model, to be applied across every infrastructure sector and project.

As we await the outcome of the government's Infrastructure Finance Review, businesses have emphasised that the identification by the government, of acceptable private finance delivery models, is a necessary outcome if the UK is to maximise private sector investment and finance in its infrastructure.

**Recommendation**

- The government should use the National Infrastructure and Construction Pipeline to outline which infrastructure projects it is seeking private finance for, and the private finance delivery model that will be utilised in each case.

This document should be published alongside or within the National Infrastructure and Construction Pipeline, clearly outlining which different models could be applied to different sectors and scenarios. This move would restore confidence in the government's appetite to facilitate private sector investment and finance in UK infrastructure, and provide a clear pathway to participation for businesses. This document could also be showcased globally to highlight and promote projects that Britain is driving.

**To support this, the CBI has consulted with its members to gather insights into each of these models and how they can be deployed effectively going forwards**

### The Mutual Investment Model (MIM)

The MIM sets the public sector as the co-owner and investor for 20% of the contract. This means 20% of the project's equity and subordinated debt entitles the public sector to up to 20% of the profits. Adopted in Wales, for the A465 project, and recently endorsed by the Welsh Assembly, businesses have noted that the model, in practice, bears resemblances to the recently discontinued PFI/PF2 model. However, businesses note that it has notable enhancements and improvements from PFI/PF2. For example, the profit-sharing element contained in MIM gives the public sector an active participatory role, as well as an ability to share profits resulting from the project. In addition, businesses have suggested the model places an emphasis on the inclusion of community benefits as a strategic outcome of its usage.

Businesses have suggested that this model could be used across the UK if the government demonstrated flexibility on its aversion to any private finance model bearing any resemblance to PFI/PF2.

### Regulated Asset Base model

Businesses suggested the development of the RAB model in the 1990s, which is transparent, independent, and stable, provided assurances to investors and lenders in the UK's utilities. The RAB model's robust regulatory regime ensured strong investment grade credit, and consequently, access to cheap debt and equity to support significant capital investment for the benefit of consumers. Businesses would like future private finance delivery models to replicate these beneficial aspects of the RAB model.

Businesses have highlighted the Thames Tideway Tunnel project as an example of how RAB, coupled with appropriate government support to create and protect revenues of stakeholders, has led to a complex construction project being delivered successfully. Thames Tideway Tunnel demonstrates what can be achieved when the public and private sectors work together to address project risks and adopt best-practice solutions. Businesses have noted that payments in respect of the asset will be met by its end-users, and the project company is therefore able to recover its costs through water charges.

However, it is important to note that the RAB model can be made to operate similarly to a Public-Private Partnership model. This can be achieved through implementing the risk allocation with less fixed price contracts and a flow-through of costs against an agreed rate of return. The discussion on private finance delivery models should be considered in terms of each particular sub-asset class.

Businesses have suggested the extension of the usage of the RAB model in existing infrastructure sectors, such as in the energy sector for new nuclear generation, and in new sectors, such as road and rail, would constitute a positive step. There is a particular opportunity to support the UK's plans for new nuclear construction using the RAB model to help balance the risks associated with such capital-intensive projects. The government should take care to communicate the virtues of the model to ensure it commands investor confidence over the long term.

However, the sector recognises that the RAB is not a panacea on infrastructure finance delivery models, and that the potential adaptation of the RAB model to social, road and rail infrastructure could be challenging.

### Regulated Infrastructure Investment (RII)

The Infrastructure Forum's report, '*Regulated Infrastructure Investment – Innovation and Opportunity*', advocated the expansion of the Regulated Asset Base model to finance infrastructure[50] arguing that the model provides a structure where risks are shared between the supply side, (including investors, contractors and developers) consumers, and the taxpayer to incentivise the delivery of investment at the best overall value for money.[51]

This structure also creates an "*enterprise-based*" approach to investment, shifting away from a reliance on contractual obligations and an associated transactional approach to service delivery.[52] Furthermore, the report contends that the proposed model avoids the past shortcomings of PFI/PF2, and if suitably implemented, has the capability to address the issue of social legitimacy related to private finance and provides the following benefits:[53]

- **Low cost of capital**, meaning the premium over the government's cost of finance is seen as better value for money.
- **Access to capability and capacity** not available to sufficient scale within the public sector.
- **Increased contestability,** including in the formation of delivery organisations.
- It creates incentives for outputs to be successfully delivered and risks well-managed as profits are linked to customer service and asset performance.

### Consumer-pay models

Businesses have also suggested that Consumer-pay models should be considered. The rail sector uses a range of end-user pay approaches, covering rolling stock and depots, and extending to major enhancements such as line extensions and tunnels.

There is precedent for inflation-plus fare rises to pay for targeted interventions. For example, the South-eastern rail franchise charged RPI + 3% from 2007 – 2012 to pay for a series of improvements. Furthermore, regional interventions in the North were funded using an RPI+5% charge.

Businesses have suggested that smaller infrastructure schemes, or elements within larger infrastructure programmes, may be fully funded if the customer base is large enough. However, businesses are conscious that farepayers are paying progressively more for rail services, with fares rising faster than income. Businesses have noted that future consumer paid interventions should be proportionate and supported with public funding.

### The Revenue, Incentives, Innovation, Outputs (RIIO) model

This is an adaption of the Regulated Asset Base model for electricity and gas transmission and distribution, with revenues set by Ofgem.[54] Businesses cite the RIIO as a beneficial finance model because it rewards the investor for providing a better service to customers, incentivising the prioritisation of consumer benefits into a project.

### Land Value Capture

This model, whereby mechanisms such as Business Rates and the Community Infrastructure Levy are used to contribute significant funds towards major infrastructure projects, has been used successfully, both internationally and in the UK, most notably with Crossrail in London. While the principle behind this – that those benefitting from the development contribute towards it – is sound, there is a question about how replicable it is in all parts of the country where the value uplift will be substantial enough to cover the costs of a project.

It should also be noted that with a 'stakeholder pays' model or ABV in this instance, calculating the value add of a rail project to individual stakeholders would in itself be a contentious issue.

## Businesses have identified common principles for future private finance delivery models to include

To ensure that finance delivery models are adopted which attract the right range of investors and funders to the UK market, government must engage widely with the market. This will also be important to ensure that potential investors have clarity as to what the government is seeking to achieve.

As argued above, businesses have suggested that a 'one size fits all' private finance delivery model, adopted to every relevant sector in infrastructure, is not achievable or desirable. Instead, industry would prefer to see the most appropriate model championed for the relevant project. The suitable model in question will depend on the sub-asset class in question and an understanding as to whether the relevant risks are investable at a reasonable return. Any future discussions of different private finance delivery models should be grounded in:

**a) The principles that underpin different structures and**

**b) The specific dynamics of an individual project or, where appropriate, sector**

Any assessment of different delivery models should focus on the appropriate allocation of risk, driven by commercial and technical considerations rather than being driven by the potential impact on the government's balance sheet.

Whichever model the commissioning body opts for, businesses would like to see this accompanied with political support. A situation where a series of private finance delivery models are launched by the government, and are followed by attacks by the media, with no rebuttals given to defend it must be avoided.

**Businesses have highlighted a series of additional existing mechanisms that could be used to facilitate private investment and finance in UK infrastructure**

### Government Infrastructure Bonds

- Businesses have suggested that government infrastructure bonds could align investment horizons with projects and provide below market-rate lending with many of the same soft benefits of European Investment Bank loans. This includes acting as a cornerstone lender on new technologies and providing countercyclical lending. Similar bond issuances for infrastructure exist internationally, such as US Municipal Bonds, which have a lower yield than US gilts, but on which income from the bond is tax exempt.

### Construction Period Support for Greenfield Projects

- Government support for certain projects during their construction period could allow for wider lender participation at an earlier stage, ultimately leading to cheaper financing and increased certainty for the relevant public bodies.
- In many cases the pool of lenders willing to finance a project during its operational phase will be significantly larger than those willing to also finance the construction period, and likewise the rate at which they will be willing to lend will be higher where the construction period is included.
- This will be most pronounced for projects with long and complex construction periods. Equalising the risk profile through support measures would allow for more efficient long-term financing to be provided at the outset.
- Such support could come in a variety of forms, from full financial guarantees covering project debt during the construction period, to more bespoke government support packages designed to insulate lenders from specific construction-related risks, such as the Thames Tideway Tunnel package.
- A UK Infrastructure Bank could have a role in providing such support, alongside existing government departments and bodies.

### Tax incremental finance (TIF)

- A further form of financing used in Scotland, and London, originating in the US, is TIF. This funds investment by utilising the tax revenues expected to arise from projects e.g. via the increase in land values and future developments. Revenues are generally capitalised through bonds and debt arrangements, which are then issued as near to completion as possible to reduce risk and the rate of interest.
- In Scotland, this form is restricted to projects which will 'unlock regeneration and sustainable economic growth' and generate additional public sector revenues alongside repaying financing costs.
- This can be a beneficial model for housing and transport infrastructure and is flexible in allowing the inclusion of development finance. However, it requires significant consultation in the project area and public body investment.

### Joint ventures

- This mechanism works in circumstances where a public sector entity, and a private sector partner, are looking to jointly develop surplus/unused public sector land. It allows for bespoke solutions that work locally.
- Each scheme is documented and, if the governance arrangements are suitable, can allow both parties to benefit and allow a project to develop over time in a way that is less cumbersome than, for example, the change mechanisms in a Public-Private Partnership project.

These existing mechanisms could be useful in attracting private investment and finance into UK infrastructure. The key consideration is identifying what specific issue each of them is designed to address, and how this will be achieved.

However, some of these mechanisms have struggled to gain traction due to factors such as being overly onerous to access and/or priced at a level that is unattractive. Some of the existing mechanisms have also been introduced without a pipeline of potential opportunities and can be seen as a 'fallback' option, which would only be utilised when conventional structures have failed to deliver.

In addition, while these mechanisms may provide value, none are as important as having:

- Consistent government public support for private investment in UK infrastructure.
- A clearly defined and private sector-facing infrastructure pipeline.
- Balanced regulatory settlements which recognise the value of private sector investment.
- Government agencies acting as intelligent buyers in line with Project 13's principles and procuring on the basis of long-term value for money, not the short-term cheapest cost.

Businesses have identified political leadership and direction in the UK's infrastructure market as areas for prioritisation, given that the UK is now competing with other, and often more proactive jurisdictions. Furthermore, the extent to which these existing mechanisms are used depends on whether the government has the capital to deploy in financing the project, and whether it is prepared to treat the project as being on balance sheet. The development of the Mersey Gateway Crossing has been highlighted as an example of good practice in this area. This development was backed by HM Treasury-granted bonds.[55]

In getting businesses to engage with these existing mechanisms, clarity is needed about government requirements and procedures. Businesses have noted that on occasion, public sector bodies have offered to provide support to businesses using the existing support mechanisms. However, businesses are obliged to obtain the contract to deliver the infrastructure project before being eligible to utilise the mechanism. In addition, to obtain the contract to deliver the infrastructure project, a business is expected to provide committed financing to demonstrate its eligibility for the project. This means that the aforementioned mechanisms are only available to businesses after they have secured an infrastructure project contract, having already provided significant committed financing.

Therefore, businesses have concluded that the availability of the aforementioned mechanisms do not necessarily facilitate a more competitive bid, and the public sector may be losing out on value for money.

Businesses have suggested that future efforts to utilise or adapt existing mechanisms should be considered alongside an understanding of how they work alongside state aid rules, particularly given the UK's exit from the European Union.

*"Businesses have identified political leadership and direction in the UK's infrastructure market as areas for prioritisation."*

# Stable independent regulation can be a catalyst for further investment in UK infrastructure

**To facilitate increased private investment in UK infrastructure, government should focus on creating a stable and enabling regulatory environment**

Achieving government policy objectives, such as reaching net-zero greenhouse gas emissions and rolling out full-fibre and other gigabit technologies, will require transformative investment in economically regulated industries including energy, transport, water, and telecommunications. For instance, the National Infrastructure Commission (NIC) estimates an additional £9 billion annual investment will be required in the power sector to meet the net-zero target by 2050,[56] while it estimates the telecommunications sector will require £33 billion investment to deliver full-fibre across the UK and £8 billion to upgrade existing infrastructure for nationwide 5G coverage.[57] Economic regulators therefore have a key role to play in creating an environment that facilitates this crucial investment.

A recent CBI report, 'Reimagining Regulation', outlined the steps necessary to create a modern regulatory environment that delivers on the investment needed for the future.[58] Since its inception, the UK's regulatory framework has successfully maintained standards, incentivised investment, and provided financial savings to consumers. Consequentially, it has become internationally regarded as a benchmark for best practice. This is demonstrated by the OECD's Product Market Regulation (PMR) indicators, which measure the regulatory barriers to firm entry and competition in the energy, transport and communications sectors.[59] In all three sectors measured (energy, transport and communications) the UK outperformed other OECD countries.

To attract the investment necessary to provide the UK with the infrastructure it requires, the UK should retain the key regulatory policy principles that have helped to facilitate the existing investment in regulated utilities over the past 30 years. At the core of this is:

- Independent regulators making evidence-based decisions, at arm's length from short-term political considerations.
- Ensuring that decisions are then subject to a proportionate but robust merits-based appeals regime.

While these principles should be retained, the role of economic regulators could go even further to help encourage this transformative investment required in the future. Ensuring the remit of economic regulators is directly aligned to government policy objectives and the work of the National Infrastructure Strategy could help to deliver improved infrastructure outcomes.

**Recommendation**

- The government should require regulators to have specific regard to deliver the National Infrastructure Strategy, including progressing towards meeting the net-zero emissions target for 2050. Each regulator must have a clear responsibility to acknowledge how regulatory policy aligns with the government's strategic objectives on infrastructure investment, including its net-zero emissions target for 2050. This would also require each regulated sector to assist regulatory decisions and reduce fragmentation between departments and regulatory bodies.

### The toolkit of economic regulators should encourage long-term investment that translates into long-term returns for private investors

Another area that could discourage private investors from investing in regulated industries is the primary focus of economic regulators on price controls. The water sector is an example of where price controls catalysed the process of removing inefficiencies in the early years of privatisation and showed tangible benefits to both firms and consumers.[60] However, price controls have since come under scrutiny for being too focused on the short term.[61] Typically, price controls are set every 5 years, which means they are unlikely to reflect the major investment needs of the sector in the long-term. Setting price caps too low can therefore result in insufficient investment and a lower quality of service.

While current investor appetite for infrastructure is high, cumulative prudential regulation may have a negative effect on an investor's ability to invest in the coming years. For example, recent price determinations in the regulated water and energy sectors placed too great an emphasis on short-term consumer affordability at the expense of long-term infrastructure investment. The Global Infrastructure Investor Association argued that an implication of this approach will be to transfer the costs for future essential investment onto consumer bills beyond this 5-year period, which is neither cost efficient nor fair in term of intergenerational equity.[62]

The 2019 price review by Ofwat demonstrates the difficulty in ensuring an effective regulatory environment which also delivers on the diverse investment needs of a complex sector. Some businesses have suggested that this move raised concerns in the stable regulatory regime which has been a hallmark of the UK's investment environment. This also has the potential to discourage new investment. For example, Moody's, the international credit rating agency, has cited the reduced stability of the UK regulatory regime as a factor in its downgrading of a number of UK water companies and in putting others on negative watch.[63] This downgrade will also act as a signal to international investors looking at the UK making it less viable for investors to justify deploying capital into UK regulated infrastructure in the future.

Recent 'minded to' decisions by Ofgem, including the RIIO-2 Draft Determinations, have been received negatively by businesses, highlighting concerns that price controls will limit the amount of long-term investment that can be delivered. This investment is crucial for enabling the transition to net-zero emissions and a balance needs to be achieved that protects consumers while ensuring businesses can invest in the infrastructure of the future.

In contrast, Ofcom is an example of a regulator that has been embarking on a regulatory regime that supports long-term investment over mechanisms such as price controls. The UK's regulatory model was effective in supporting superfast broadband investment, but was far less suited to the larger, riskier infrastructure investment required for nationwide gigabit-capable connectivity, which will need to be rolled out ahead of widespread demand.

The use of price controls is not the only mechanism available to regulators and in fact, can distort investment decisions over a longer time horizon. The economic regulation of the water sector in Scotland has taken a different approach to assessing long-term investment requirements with regulators, companies and consumer bodies working together to agree that a long-term step change in investment is required to secure service levels for future generations coupled with relative price stability.

The approach taken in other countries also differs to that of the UK. Evidence from Australia shows the impact of introducing a new regulatory model following a substantial review into why the previous model was not delivering the desired outcomes.

**Case study: The Australian PREMO pricing framework retains many of the strengths of the traditional RAB model, while increasing the focus on value creation, innovation, and rewarding businesses that meet the needs of their customers and communities[64]**

In 2016, the Australian state of Victoria introduced a new water pricing framework: Performance, Risk, Engagement, Management and Outcomes (PREMO).

Independent economic regulation of the water sector in Victoria began in 2004. After ten years the regulatory framework was leading to:

- Lower efficiency gains with each subsequent round of determinations
- Ambivalence towards costs and risks being transferred to the customers and the community
- Little evidence of innovation or ambition in service delivery
- Limited role for customers in informing water businesses' planning decisions
- Prolonged debates on the minutiae of pricing models and performance measures
- Limited engagement by senior management and directors in price submissions.

In 2016, after extensive consultation, the state's independent regulator, the Essential Services Commission (ESC), introduced a new regulatory model, the 'PREMO framework'. The framework focuses businesses on the demonstrable and efficient delivery of value to customers and communities.

Price proposals must be developed in accordance with the ESC's assessment framework which is published in advance. The level of a business's ambition determines the return on equity it earns for the duration of the regulatory period. Boards must attest that they have self-assessed their proposal against the framework. Businesses are penalised if they attempt to game the regulator through the self-assessment process. In 2018 the ESC approved 14 of the 16 price proposals submitted by the businesses.

Unlike all other regulatory pricing frameworks, the PREMO model ties the returns on equity to the benefits to be delivered by a water supplier to its customers. In this sense, water businesses are free to determine their own rates of return by choosing how ambitious they wish to be.

The PREMO model also eliminated many of the most arcane features of price regulation such as estimation of equity betas and market risk premia, which represent continuous and costly distractions for businesses and the regulator. Removing these distractions allows the businesses to focus on their core responsibility of delivering value for money to their customers.

To encourage genuine long-term investment, the UK's regulatory framework should consider alternative tools beyond short-term price controls. For example, an upfront recognition of the risk investors take when undertaking long-term investment provides transparency about how the regulator will assess whether future returns are commensurate with that risk.

**Recommendation**

- The government should launch a call for evidence on the broader tools available to achieve its long-term investment ambitions.

Additionally, the UK Regulators Network should report on the tools available to regulators to drive innovation, drawing on international experience and business consultation.

**Recommendation**

- Regulators should expand their toolkit beyond price controls. The use of price controls can lead to underinvestment given their short-term nature. Regulators must explore better complementary alternatives to deliver the transformative investment required.

# To improve infrastructure delivery, there must be a renewed focus on public sector commercial behaviours

Maintaining a strong domestic market to deliver infrastructure will remain vital for the government if it is to raise the attractiveness of a buoyant, capable, and innovative market for investors.

### Flawed procurement and contract management practices continue to weaken the UK infrastructure market

Procurement of infrastructure has consistently been raised by industry as a frustration, with concerns around risk management, a lack of project management resource, and insufficient commercial capability within government. The CBI's 2018 public procurement survey found that over a third of businesses felt the government's handling of risk had deteriorated since 2015, with almost half stating there had been no improvement during this period.[65]

Too many infrastructure projects are procured in an onerous and overly complex manner, in part due to a reliance on standard forms and processes which are overly bureaucratic. This places a burden on businesses, reduces competition and ultimately can lead to poor value for money being delivered for taxpayers.

To start to tackle these issues, public sector commissioners must shift their focus away from short-term cost-reduction and place much greater emphasis on delivering long-term outcomes and generating social value through investment in infrastructure.

Steps should also be taken to ensure projects appropriately transfer contractual risk, and that contracts contain less prescriptive project specifications to enable greater innovation and consideration of future technological developments.

### There is an urgent need to improve the handling of risk in construction sector projects

Fair and transparent risk allocation has been identified as a crucial enabler of private investment and finance in UK infrastructure. The increased aversion to risk in the public sector has seen government procurers transfer more responsibility for risk to the private sector. Frequently, however, this is a move that shifts up-front capital costs to the private sector but does not consider how that impacts the ability for suppliers to successfully deliver the infrastructure required.

Too often public bodies prioritise the placement of risk off balance sheet, and that it too frequently opts for the cheapest possible deal rather than focussing on the outcomes that deliver long-term value for money. Current risk-sharing mechanisms also place a heavy burden on contractors, as financing partners are increasingly seeking compensation due to low Net Present Value (NPV) requirements. This often results in the public sector transferring significant levels of risk onto the private sector, which in turn sees contractors passing this risk down through the supply chain. There are examples in the Canadian market where the government provides a more suitable risk allocation for both the private and the public sector, even if this means having the project on balance sheet as it provides value for money to the client overall.[66]

Businesses have noted that the current approach to risk transfer is focused on a number of subjective assumptions, which provide a false level of certainty to the government before a project begins. This approach also implicitly assumes that there is infinite capacity for the public sector to finance projects.

Often, the cost implications of technical and varied risks inherent in an infrastructure project are assumed and priced into a fee before on-site risk analysis has been conducted. Contractors delivering infrastructure projects acknowledge the effectiveness that cost control can play in inspiring competitive tendering and innovation. But driving down capital costs before engaging the firms who can offer technical, evidence-based advice on risk assumptions poses a real threat to the success of projects. In all likelihood, once tendering begins, a gap will emerge between the price clients are expecting to pay, and the valuation from the businesses contracted to manage the risk.

In other parts of the public sector market, businesses are beginning to report improvements in how public bodies are handling and managing risk. Much of this is credited to the creation of the Outsourcing Playbook which lays out a number of principles of best practice for government's relationships with its suppliers. The first two iterations of the Playbook have not explicitly applied to infrastructure projects, but the government should now look to extend its recommendations on risk in particular to all built environment contracts.[67] This should include public sector commissioners establishing joint risk registers with bidders and ensuring contracts do not ask suppliers to take on unlimited liabilities.

**Recommendation**

- The government should embed the principles on risk allocation in the Cabinet Office's Outsourcing Playbook across built environment contracts.

If embedded, the principles will help create a sustainable basis for investment. If bidders know what the risk/reward balance is for a project, it can then be priced. In the past, the structuring of specific procurements has not always achieved this balance: despite best intentions, often the temptation for procurers to allocate too much risk (and to micromanage inputs) has proved too strong at the point of competition design. To ensure that private investment is better utilised, this disconnect between the sensible principles of the Playbook and the point of implementation should be tackled.

If some projects have a clear risk balance and others do not, a lack of consistency will reduce the private sector's overall willingness to participate, and will also drive up costs for the government as the lack of consistency will be priced in. Recent infrastructure procurement processes such as Silvertown tunnel, the A465 in Wales or A303 are cited as examples of unbalanced risk profiles which resulted in contractors exiting the procurement process.

To mitigate this, bringing suppliers' expertise into a procurement process early on, before a budget is agreed and tendered, would support more effective scoping and designing of public sector infrastructure projects, meaning they benefit from greater certainty around what will be delivered and when. This would in turn give more confidence to investors looking to back infrastructure projects that they will see a return on investment.

In addition, businesses have made clear that the private sector cannot assume open ended obligations. For those areas (e.g. unknown conditions, site risk, indemnities, injurious affection) a risk share mechanism, collaborative approaches with clients and ensuring capped exposure to risk for the private sector could be helpful to attract competitiveness to the procurement. To make this more effective, government should ensure consistent interaction throughout the procurement process with the private sector to understand their concerns.

Businesses have noted that the private sector are generally unwilling to finance greenfield projects where it is not able to adequately transfer construction risk to a contractor. This can impact on competition, and in certain cases, can lead to a failed procurement. Businesses have highlighted a number of challenges in this area, including:

- Limited willingness of the construction sector to enter into fixed price and date-certain contracts. This is particularly the case regarding large-scale projects and those that involve tunnelling.
- Many UK contractors are thinly capitalised and do not have sufficient financial resources to stand behind their contractual commitments if something should go wrong and costs spiral. Businesses have noted a particular concern about concentration risk to a specific project (e.g. new build nuclear).
- There is also an increased emphasis, particularly amongst investors and lenders, on delivering projects that align with Environmental, Social and Governance (ESG) criteria. Projects that do not meet these criteria may be increasingly difficult to finance.

Regarding balance sheet considerations, steps to address these challenges were proposed in the CBI's report, '*Fine Margins*',[68] which called for procurers of major projects to conduct a robust analysis of supplier balance sheets, looking at measures such as a business's operating margin at year-end or period-end over recent financial reports to identify profitability.[69] A consistent positive margin suggests a sustainable approach to operating. A consistently negative margin indicates problems that quickly need addressing. A combination of both may be explained by exceptional charges or one-off costs but would still require further scrutiny.

A business' net cash/debt position at year-end or period-end over recent financial reports can also be evaluated.[70] A consistent positive net cash position (higher liquidity than short and long-term debts) suggests a sound underlying financial performance. A consistent or widening positive net debt position (higher short- and long-term debt value than current liquidity) may indicate financial vulnerability.

The report also recommended that the ratio of a business's current assets to current liabilities (working capital ratio) should be taken into account.[71] Generally, a ratio of between 1.0 and 2.0 is considered to be secure, though other ratios can be adjudged secure depending on other financial factors.

**Recommendation**

- Public and private sector clients should be required to make a credible and consistent assessment of balance sheet strength during the first stage of a procurement process.

The measures listed above are suggested as a framework for a balance sheet assessment.[72] New structures and principles for projects that may be developed will require consultation with the private sector to ensure that they are capable of being implemented. In particular, there is a tendency to overestimate the capacity and willingness of the construction market to deliver under certain structures. Regarding the construction phase of infrastructure projects, indicators of the financial and credit health of suppliers and/or contractors should be monitored during every stage leading up to project delivery.

In addition, consistent analysis of procurements should be adopted so that the government learns any lessons emerging from past experiences to adapt frameworks and lead to successful delivery. Transparent procurement processes, with certainty on project timelines, and an objective evaluation criterion, would increase confidence in the UK's infrastructure market and attract multiple and sophisticated bidders.

The government should look globally for international examples of best practice regarding procurement models. For example, the Alliance model, which is broadly accepted in other markets such as Australia and Canada, is based on a collaborative approach between the public and the private sector that translates in enough flexibility to determine the scope and the price of the project and the establishment of risk-sharing mechanisms.

Closer to home, the emergence of 'alliancing' approaches to procurement in the UK, such as Project 13, point the way to equitable and stable sharing of risks between parties involved in financing and delivering major projects. Project 13 is a blueprint for a new business model for delivering infrastructure projects and outlines the requirements of the 'asset owner' that moves beyond those of a more traditional client. The model suggests that the owner, responsible for operating the asset, should be looking to drive the optimal lifetime performance of the asset, requiring the best possible construction and maintenance.

The asset's budget holder – the investor – should be using the budgetary scope to incentivise the suppliers to work towards achieving the same outcome. The principles in the Project 13 approach place a responsibility on clients to understand how allocating risk effectively at the outset of projects can drive cost and performance gains over the whole life of an asset. This encourages the investor or owner to accept more of the risk profile at the outset, as they stand to benefit most from the successful delivery of their asset.

Operating in such a way can give greater confidence to the businesses delivering an infrastructure project and is more likely to head off delays and disputes, giving investors more confidence in the timely delivery of their asset and early return on investment.

In addition, a culture of risk aversion in the UK civil service can hamper innovation, with contractors suggesting that civil servants currently have little incentive to take risks or innovate. Businesses have partially attributed this to departments being focused on keeping capital expenditure low, and public sector contracts being exposed to public scrutiny, be that from the government, journalists, Parliamentary select committees, or the National Audit Office.

This overall environment could be particularly problematic for UK businesses, noting increasing involvement in the market by international contractors, predominantly from countries such as Spain, France, Germany, and South Korea. However, those firms rely on the expertise and experience of UK businesses to operate successfully in the UK.

Some businesses have suggested they are experiencing a reduction in willingness of banks to lend, wanting to reduce their exposure to firms in the construction sector. There are also increasing problems with the cost of insurance for firms that would deliver infrastructure throughout the supply chain, which Covid-19 disruption has exacerbated. This is partially attributed to previous market failures such as Carillion, but also high-profile project overruns and negativity around the sector due to the Grenfell tower tragedy. Furthermore, businesses have suggested the construction industry's appetite to deliver infrastructure projects has decreased, due in part to the government's historical approach to risk transfer to the private sector against the low margins available. With financial institutions viewing the infrastructure sector as high-risk, attracting private capital from investors into projects becomes an even more important source of finance.

### Government should work with industry to develop a mechanism for bringing forward market-led proposals for infrastructure projects

The rules for private sector engagement remain unclear for market-led proposals. Considerable costs are often incurred during the design and development stages, and there is no protection or confidentiality for the proposal as government often then brings the idea to market for competitive bidding. Protections of intellectual property and/or compensation payments for market-led proposals could be put in place to incentivise the private sector to come forward with proposals.

There is little reason the Department for Transport's (DfT) guidance on Market-Led Proposals, which encourages private companies to submit ideas to the DfT for improvements and additions to the current rail network, could not be applied to other sectors across infrastructure delivery, and adapted to the requirements of other government departments.[73] The guidance outlines how the private sector can be incentivised to bring forward proposals before tenders are in the market, such as by reimbursing costs of intellectual property development once ideas are taken forward. Supporting more proactive private sector involvement could further increase confidence in projects making their way through the pipeline, as well as encouraging innovation.

As the Infrastructure & Projects Authority is well established as the government's *"centre for expertise for major projects"*,[74] reporting into HM Treasury and the Cabinet Office, this centralised body and function could be leveraged to establish cross-government guidance on Market-Led Proposals. The IPA could identify and share best practice, built on the lessons learned from DfT projects, to create a set of principles through which other central government departments could encourage market-led proposals for projects across the public sector, for example, in health, justice or education.

**Recommendation**

- As the government's centre of expertise for major projects, the IPA should develop a set of principles and accompanying guidance to support all central government departments in bringing forward market-led proposals for delivering major public sector projects.

### Greater flexibility on contracts, and a broader promotion of transparency and collaboration on public-private contracts are short term measures that could improve the UK's infrastructure finance market

Businesses would like to see a move away from the conventional Net Present Value (NPV) calculation and an improvement on the applicability of standard form contracts for modern projects. As technology develops, contracts will need to be drafted based on assessing risk over a long-term period of up to 25 years. In addition, businesses would like to see the government explore the viability of contracts containing cost-plus pricing, and profits capped with options for an appropriate level of risk transfer, conducted on an open-book accounting basis.

A re-evaluation of the method used to price contracts would also be welcomed by businesses. Indeed, attempts to cost a 10-year construction programme on a 25-year operating period rarely delivers value for money, because estimations at the outset about cost and delivery are especially difficult to make without substantial data.

It is necessary to move away from the NPV calculation because this often leads to the cheapest option winning contracts. Businesses have observed that if value for money is primarily assessed by lowest cost, equity may be driven out of the UK infrastructure finance market, as the consequence of this approach will result in low margins for investors, yielding minimal returns. Therefore, in this context, businesses have noted that it may make more financial sense to invest in other countries. In the government's Outsourcing Playbook, guidance recommends outsourcing teams undertake 'should-cost modelling' for complex outsourcing contracts.[75] In the CBI's report, '*Markets for Good*', the business environment welcomed this development, and called for this model to be extended to construction and civil engineering projects.

Governmental bodies should consider the cultural behaviours they adopt to obtain the maximum value from a project. For example, businesses are often asked to price projects before there is enough knowledge to accurately assess the risk that may be involved. This could be mitigated if the government promoted a culture of transparency and collaboration across all parties involved in the delivery of infrastructure projects, aimed at finding the best value for money rather than driving down cost.

### Government should recognise the long-term benefits and social value created by the private sector in delivering infrastructure

To mitigate the public sector's exposure to risk, government should also ensure that the private sector's role in building and operating infrastructure is rewarded more frequently for meeting long-term objectives and delivering social value. This should include reducing the environmental impact of infrastructure projects, increasing the government's return on investment, and delivering anticipated social benefits such as job creation within a local community. As stated above, tools such as the balanced scorecard, which attempt to consider some of these factors, have not yet yielded sufficient impacts in practice.

Social Value has already been identified by Cabinet Office and Number 10 as one crucial policy for shifting the focus away from lowest-cost to maximising the social, environmental, and economic benefits generated by public-private partnerships.

Already widely used in the construction sector and by local authorities and embedded law via the Public Services (Social Value) Act 2012, the social value of bidding businesses is often considered during the tender process alongside price and quality as a determining factor in winning contracts.[76] To help drive the consistent adoption of social value across central government, a new social value framework developed by the Cabinet Office is due to be released in summer 2020 and will give social value a mandatory minimum weighting of 10% in all government contract awards going forward. As this framework rolls out, the Cabinet Office should work closely with the IPA and BEIS, as well as local authorities, to monitor how infrastructure projects are taking account of social benefits.

**Recommendation**

- The government should ensure that public contracts incentivise businesses, involved in building and operating infrastructure, to meet long-term objectives, as well as short-term delivery goals.

# Methodology

To inform the recommendations laid out in this report, the CBI consulted a wide range of businesses and associated policy organisations across the infrastructure sector. This included infrastructure providers, legal services, banks, investors, consultants, and construction companies.

Businesses were invited to share their views on topics including: the barriers to private finance and investment in UK infrastructure, the National Infrastructure and Construction Pipeline, the UK infrastructure market's governance arrangements, and infrastructure finance delivery models.

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# About the CBI

Founded by Royal Charter in 1965, the CBI is a non-profit business organisation that speaks on behalf of 190,000 UK businesses of all sizes and from across all sectors, employing nearly 7 million people between them. That's about one third of the private workforce. This number is made up of both direct members and our trade association members. We do this because we are a confederation and both classes of membership are equally important to us.

The CBI's mission is to promote the conditions in which businesses of all sizes and sectors in the UK can compete and prosper for the benefit of all. With offices around the UK (including in Scotland, Wales and Northern Ireland) and representation in Brussels, Washington, Beijing and Delhi, the CBI communicates the British business voice around the world.

## Our mandate comes from our members who have a direct say in what we do and how we do it

The CBI receives its formal mandate from 9 Regional Councils, 3 National Councils from Scotland, Wales and Northern Ireland plus 16 sector based Standing Committees. These bodies are made up of members in that region, nation or sector who serve a term of office. The chair of each Standing Committee and Regional and National Council sit on the CBI's Chairs' Committee which is ultimately responsible for setting and steering CBI policy positions.

Each quarter this formal engagement process across the CBI Council reaches over 1,000 senior business leaders across 700 of our members who have a direct say in what the CBI do and how they do it, from refreshing their workplan to discussing the key business issues of the day and re-calibrating its influence. Over 80% of the businesses represented on the CBI Council are outside of the FTSE350 as the CBI represents a wide range of sizes and sectors from the UK business community. This formal governance process is supported by a wide range of working groups, roundtables, member meeting and events that makes the CBI unparalleled at listening to and representing British business.

# CBI Council in numbers

1000+

Committee and Council representatives

28+

Regional and National Council and sector based Standing Committees

50%

Representatives of the CBI Council at C-Suite level

80%

Of the CBI Council from non-FTSE 350 businesses

September 2020


Product code: 12610

Produced by Daniel Woolf and the Infrastructure and Energy team
To share your views on this topic or ask us a question, contact:

**Daniel Woolf**
Senior Policy Adviser
daniel.woolf@cbi.org.uk