National Audit Office

Report
by the Comptroller
and Auditor General

Department of Energy & Climate Change

Investigation into the Department of Energy & Climate Change's loans to the Green Deal Finance Company

HC 888 SESSION 2015-16 14 APRIL 2016

What this investigation is about

1 In 2013 the Department of Energy & Climate Change (DECC, the Department) launched the Green Deal. It intended to increase the energy efficiency of Great Britain's housing stock with the scheme, by enabling consumers to access loans to finance measures that would improve the energy efficiency of their homes. Consumers would repay the loans through their energy bills, with repayments offset by lower bills resulting from lower energy usage.

2 The Department, a group of energy companies and organisations intending to be Green Deal providers established the Green Deal Finance Company (the finance company) in 2012.[1] This not-for-profit company provided finance to Green Deal providers, which agreed loans with consumers. The Department was reliant on the finance company for achieving its aims for the scheme as it wanted the private sector to provide finance for Green Deal loans. Along with private investors, the Department provided a 'stakeholder' loan to the finance company to cover its early costs. The finance company expected to become self-financing once revenue from loan arrangement fees and repayments was sufficient to cover its operating costs. According to the Department, this would happen once the total value of the loans arranged was between £450 million and £500 million.

3 The finance company has incurred large financial losses since the start as a result of low demand for Green Deal loans. It has come to rely on loans from the Department to continue purchasing Green Deal finance plans. In total, the Department has issued loans worth £48.5 million to the finance company. On 23 July 2015 the Secretary of State announced that the Department would not provide any further funding to the finance company. The finance company has not offered to purchase Green Deal finance plans since that date, effectively bringing the Green Deal to a halt. The Department now expects to recover around half the money it has lent to the finance company (**Figure 1** on page 6).

4 We have investigated whether the Department took appropriate actions to protect taxpayers' money, and whether it adequately considered the risk of non-repayment when it made loans to the finance company.

1 Green Deal providers are companies that are responsible for arranging household assessments and the installation and financing required for any subsequent measures.

5 This investigation sets out the facts relating to:

- the Green Deal Finance Company, its governance and costs;
- the Department's £25 million stakeholder loan; and
- the Department's £34 million senior loan (of which the finance company has drawn down £23.5 million).

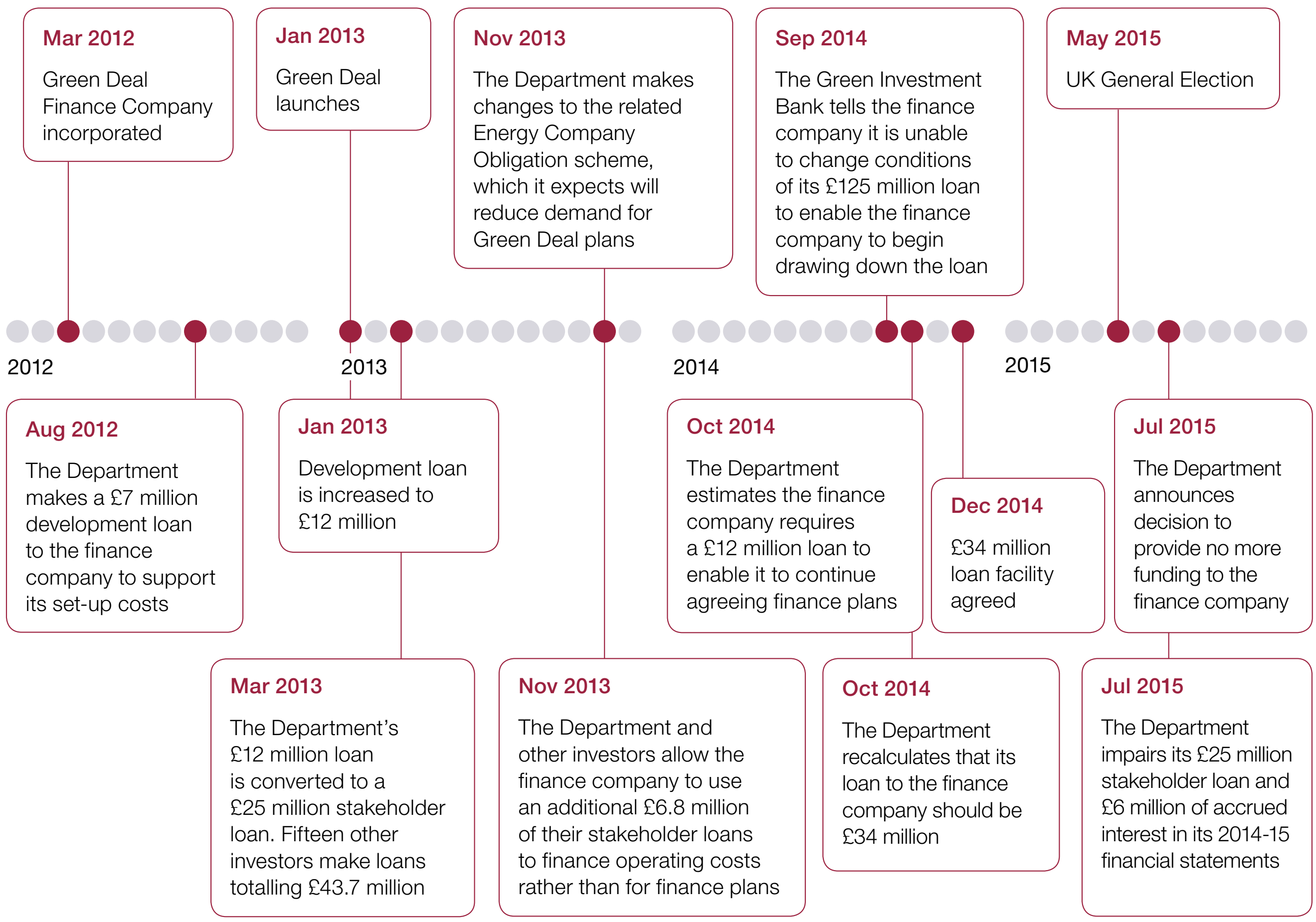
6 In a separate report, we have considered whether the Department achieved value for money from the Green Deal and the complementary Energy Company Obligation scheme.[2]

7 We have reviewed the Department's business cases and ministerial advice which supported its investment decisions, along with the annual reports and accounts of the Department and the finance company. We have also interviewed Department officials and senior figures at the finance company. Our methodology is set out in Appendix One.

2 Comptroller and Auditor General, *Green Deal and Energy Company Obligation*, Session 2015-16, HC 607, National Audit Office, April 2016.

Figure 1

Timeline of the Department's loans to the finance company



Date	Loan	Purpose	Amount	Interest rate	Debt seniority	Impaired?
August 2012	Development loan	Support finance company's set-up costs	£7 million, increased to £12 million in January 2013	Incorporated into stakeholder loan (see below)		
March 2013	Stakeholder loan	Finance Green Deal plans and attract private investment. Private enterprises invest £43.7 million at the same time	£25 million (including £12 million development loan)	14.0%	Junior to other creditors – stakeholder investors would be the last to be repaid in the event of insolvency	Yes
December 2014	Senior loan	Enable the finance company to continue purchasing Green Deal loans until just past the 2015 General Election	£34 million (the finance company has drawn down £23.5 million)	5.7%	Senior to all other investors – the Department would be the first to be repaid in event of insolvency	No – to be confirmed in course of our 2015-16 financial audit

Source: National Audit Office analysis

Summary

Key findings

8 **The Department of Energy & Climate Change (the Department) loaned £48.5 million to the Green Deal Finance Company (the finance company) between 2012 and 2015 but only expects to be repaid the £23.5 million of this that it invested as senior debt.** The Department made two loans to the finance company. In March 2013 it agreed a stakeholder loan worth £25 million. In December 2014 it agreed a senior loan worth up to £34 million. In July 2015 the Department decided not to provide any further funding to the finance company, bringing the Green Deal finance scheme to a halt. While it retains the legal right to the stakeholder loan, the Department has impaired the £25 million loaned, plus £6 million of interest that has accrued on it. The finance company has drawn down £23.5 million of the senior loan. The Department still expects to recover this in full as it is secured against the finance company's loan book and will be repaid before other investors' loans to the finance company are repaid (Figure 1, paragraphs 2.1 to 2.3, 2.12, 3.1 to 3.5 and 3.10).

£25 million stakeholder loan

9 **The Department made its £25 million stakeholder loan to provide greater confidence to potential private sector investors in the finance company.** The Department originally wanted the private sector to provide the finance required for the finance company to reach operational sustainability. However, market testing identified that government support was required to achieve a low interest rate on Green Deal loans for consumers, a crucial factor for the success of the scheme, and to build investor confidence in the new scheme. The Department provided a stakeholder loan, alongside £43.7 million from private investors (of which £33.7 million was issued at the same level of seniority, and £10 million was senior to the Department's investment). The Department issued the stakeholder loan in the hope that it would allow the company to attract subsequent investment. The Department and the private investors charged the finance company 14% interest on their stakeholder loans to compensate for the risk of holding junior debt, which would be the last to be repaid in the event of insolvency (paragraphs 2.2 to 2.5, Figure 4).

10 The Department based its stakeholder loan on forecasts of significant consumer demand for Green Deal loans. The Department's business case for its original £25 million investment cited the finance company's business plan base case forecast that it would purchase approximately £300 million-worth of loans a year. This level of demand for Green Deal loans would have enabled it to begin repaying the Department's stakeholder loan within two years. The finance company has told us that its base case was based on projections that its investors and the Department had prepared. The Department's forecast was included in its 2012 impact assessment for the Green Deal. But the Department did not intend this to be a robust forecast of demand for Green Deal finance, given the innovative nature of the scheme (paragraph 2.6 to 2.8, Figure 5).

11 Demand for Green Deal finance plans was lower than the Department's forecast from the outset, which meant the finance company could not cover its operating costs with arrangement fees and loan repayments. In November 2013 the Department and the other founder investors allowed the finance company to allocate an additional £6.8 million of the stakeholder loans to fund its operating costs. The finance company's loan book was worth just £17 million at the end of 2014, compared with the Department's impact assessment prediction of £695 million. We report in our value-for-money report *Green Deal and Energy Company Obligation* on some of the reasons why demand for Green Deal loans was lower than the Department expected (paragraph 2.9, Figure 5).[3]

12 Low demand for Green Deal loans meant the finance company was unable to access a loan from UK Green Investment Bank plc (GIB). GIB is a government-created provider of finance to green projects, which operates on commercial terms. The finance company had conditionally agreed a loan facility worth £125 million with GIB. Using more of the stakeholder loans to fund operating costs meant the finance company had broken a condition of being able to draw down GIB's loan. At the time, GIB felt it was unable to renegotiate the terms of the loan without seeing a new business plan. In September 2014 the finance company asked GIB to extend the facility, as it was due to expire at the end of that year. GIB again felt unable to meet the finance company's request as an extension would not be within GIB's mandate to provide finance on commercial terms (paragraph 2.10).

3 Comptroller & Auditor General, *Green Deal and Energy Company Obligation*, Session 2015-16, HC 607, National Audit Office, April 2016.

£34 million senior loan

13 **In December 2014, the Department provided a senior loan facility worth up to £34 million.** GIB's decision not to extend its loan facility meant the finance company was close to being unable to commit to buying new finance plans, leading it to approach the Department for additional funding. The Department initially estimated the finance company needed a loan worth £12 million to reach sustainability. This was based on new forecasts for uptake of Green Deal plans and an assumption that the finance company could reduce its operating costs by £2 million a year. The finance company, however, requested around £40 million. It based this on demand for Green Deal plans at the time being higher than the Department thought, and because it could not reduce operating costs by £2 million while maintaining its activities. The Department accepted the finance company's position and settled for the finance company reducing operating costs by around £0.3 million per year. Four days after its original proposal, the Department recommended to the Secretary of State to approve an increased loan facility of up to £34 million. Its loan conditions included the right to stop making the facility available before the finance company had drawn down all the money (paragraphs 3.1 to 3.4).

14 **The Department understood that there were a number of risks which meant the second loan could add to taxpayers' losses.** It was concerned that the increased demand for Green Deal plans was temporary as a result of its Green Deal Home Improvement Fund scheme, which offered households subsidies for certain measures. But it decided it was still worth making the loan due to the reputational risk of Green Deal finance being unavailable, even for a short period, and the strategic importance of keeping the Green Deal framework up-and-running to attract more investment in the future. The Department decided a £34 million loan was necessary to fund demand for Green Deal finance until just after the 2015 General Election. It hoped this would give the new government the chance to take a decision on the future of the Green Deal, at which point potential private investors would obtain greater clarity on the scheme's prospects (paragraph 3.5).

Finance company costs

15 **The finance company's operating costs were based on the forecasts of significant demand for Green Deal plans.** It aimed to recruit staff of a calibre appropriate to manage a loan book worth hundreds of millions of pounds: it paid its 13 members of staff £1.3 million in 2014, including a £400,000 salary for its chief executive. It also paid its IT provider £1.5 million per year as part of a fixed-cost contract, as it expected to require a system that would underpin 3.5 million finance plans. In total, the finance company accumulated operating losses of £45.5 million by December 2014. It had purchased or agreed to purchase Green Deal finance plans worth £23.7 million by that date (paragraphs 1.7, 1.8 and Figure 3).

16 **The Department was able to monitor the finance company's performance and costs throughout.** It had an observer role on the finance company's board and attended investor meetings. It received ongoing monitoring information on the finance company's performance, which included monthly information on the number of loan applications received each week and the average Green Deal plan size. The monitoring information also included the amount of loan finance which the finance company had drawn down, and a prediction of how long the loan would continue to support the finance company at the current rate of drawdown (paragraphs 1.4 to 1.6).