National Audit Office

Report
by the Comptroller
and Auditor General

Department for Business, Energy & Industrial Strategy
UK Government Investments

The Green Investment Bank

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Key facts

100	2.5:1	£1.6bn
projects financed by the UK Green Investment Bank (GIB) before March 2017	ratio of private capital attracted for every £1 GIB invested	net proceeds paid by Macquarie to buy GIB excluding retained assets

£2.3 billion total transaction value of the GIB sale, including around £500 million of commitments that will be met by Macquarie

£186 million premium of sale price over taxpayer investment in GIB (excluding estimated financing costs of around £60 million)

17.5 months is the length of time the sale process actually took, more than twice as long as indicated in planning

£12.0 billion is the value of projects financed before March 2017, including GIB and private capital

3.5 years is the length of time GIB was operational before the government launched the sale

Summary

1 The UK has obligations under international agreements and national law to move to a greener economy. In 2011 the Department for Business, Innovation & Skills, now the Department for Business, Energy & Industrial Strategy (the Department), estimated that the UK needed investment of up to £330 billion to meet those obligations over the decade to 2020, an average of £33 billion a year – double the forecast rate.

2 The government identified market failures affecting the flow of investment into the green economy, and decided that an intervention was needed to address these failures and increase investment. In October 2012 the government established the UK Green Investment Bank plc (GIB) to "accelerate the UK's transition to a greener, stronger economy" by investing in green projects.

3 In June 2015 the government announced plans to bring private capital into GIB. In March 2016 it launched a process to sell GIB into private ownership. The Department (through its Shareholder Executive arm) planned the sale; UK Government Investments (UKGI), formerly the Shareholder Executive and set up as a government company wholly owned by HM Treasury in April 2016, ran the sale process.

4 In October 2016 the Department entered an exclusivity period with a Macquarie Group led consortium. Following a series of delays, including an unsuccessful application for judicial review from another bidder, in April 2017 the Department announced a sale to its preferred bidder. The sale formally completed in August 2017 with Macquarie paying £1.6 billion and government retaining a stake in a small number of assets it values at around £132 million.

Study scope

5 This report examines the GIB as an intervention. Part One examines the creation of GIB, how clear objectives were, and how GIB was set up. Part Two considers GIB's operations and activity, its performance against its objectives, and the Department's monitoring and evaluating arrangements. Part Three examines the sale of GIB, considering the sale objectives, preparations for the transaction, sale proceeds and outcomes, and arrangements for GIB's future after the sale. Our methods are set out in Appendix One.

Key findings

Creation and effectiveness of GIB

6 **The Department set up GIB with a clear rationale, mission and objectives to help the government achieve its commitments on climate change.** The Department developed a clear rationale for its intervention, building on cross-party political support for a green investment bank. GIB's objectives included attracting co-investment from private investors, and delivering both green impact and financial returns on investments. The Department also expected GIB to align with wider public policy objectives, but to be sufficiently independent to demonstrate that green investment is commercial and profitable (paragraphs 1.5 to 1.7, 1.13 to 1.17, Figure 2 and Figure 3).

7 **GIB's structure as a public company gave it sufficient freedom to pursue its objectives and intentionally constrained its investment activities.** The Department considered several forms of intervention, deciding that a separate financial institution was best placed to understand and address the market failures. The Department implemented sound oversight and governance arrangements that allowed GIB sufficient operational independence and flexibility to pursue its objectives. HM Treasury initially agreed to fund GIB until 2015, with European Commission state aid approval for GIB's activities needed for public funding to continue beyond 2016 (paragraphs 1.8 to 1.12, Figure 4 and Figure 5).

8 **GIB has invested in and attracted private capital to each of its approved sectors.** By March 2017, GIB had invested in 100 projects, committing £3.4 billion of its own capital. It had attracted £8.6 billion of private capital, equating to around £2.50 for every £1 invested. This represents capital committed to green projects, which developers draw down as required; the amount of cash deployed is therefore lower. At March 2017, GIB had deployed £1.5 billion of funds to projects, with £544 million still to be drawn down. GIB has committed capital to each of its priority sectors. The portfolio's projected rate of return was 10% at the end of March 2017. GIB has reported impact against each of its green metrics, and anticipates that its impact will grow in future as more projects become operational (paragraphs 2.2 to 2.9, Figure 6 to Figure 9).

9 **The Department lacked clear criteria or evidence to judge whether GIB was achieving its intended green impact.** The Department wanted GIB to be an "enduring institution", but did not make clear what this would mean in practice when establishing the bank. The Department and GIB commissioned an independent evaluation which concluded in August 2015 that GIB was addressing market failures: in offshore wind (where GIB has committed around 46% of its capital); and waste and bioenergy (where it has committed around 34% of its capital). The Department told us this finding was supported by other informal evidence. However, the evaluation noted methodological challenges in the assessment, and indicated less certainty around GIB's impact in other sectors, such as non-domestic energy efficiency and onshore renewables (paragraphs 1.13 to 1.16, 2.10 to 2.15).

10 The government decided in June 2015 that further public funding was not affordable, and announced it was considering plans to sell all or part of GIB. Within the context of GIB continuing as an institution, the Department explored options with GIB for giving it the ability to raise its own debt or equity through private capital, including selling all or part of GIB. HM Treasury indicated that it would fund GIB to meet its existing commitments and would make limited additional funding available to GIB for further investments. Failure to fund GIB further would undermine its ability to continue as an institution. After concluding from early feedback that there would be sufficient interest, the Department announced it was considering plans for a sale. The key objectives for the sale in the Department's business cases were to: secure value for money for the taxpayer; and to declassify GIB from the public sector balance sheet and reduce public debt. The Department also told us it wanted to allow GIB to raise its own finance. Subject to meeting its key objectives, the Department wanted assurance that GIB would continue to focus on green sectors and to play an important role in further accelerating the UK's transition to a more sustainable low-carbon economy (paragraphs 1.12, 2.13 to 2.14, 3.2 to 3.3).

The sale of GIB

11 The Department considered different options for GIB's future but focused on those more likely to meet all of its objectives, including declassification to reduce public debt. The Department developed a long list of seven options and assessed these against its objectives for the future. It only carried out an economic appraisal of the 'do nothing' option, and the two options that would achieve the declassification objective. The Department rejected other options, including ones where the government would retain a share. The Department considered the impact of the sale on government's primary debt measure, although the impact of the sale proceeds is smaller using a broader measure the Chancellor adopted in November 2016 (paragraphs 3.2 to 3.5, 3.29, Figure 12 and Figure 17).

12 The sale achieved limited competitive tension, and the Department and UKGI had to develop a fall-back option after launching the sale. In pre-marketing there was investor interest in buying either GIB's assets or the whole company. UKGI initially told bidders it aimed to sell at least 75% of the shares to a single bidding entity. Late in Round 1 UKGI became concerned that the transaction would fail due to a lower level of investor interest than expected and developed a fall-back option. UKGI told bidders in Round 2 that its preference was to sell 100% of the shares. It received two final bids, both of which were below but close to its minimum acceptable valuation. UKGI judged that Macquarie's offer was preferable as it was more likely to meet the declassification objective of the sale, was higher in value, and there was uncertainty over the other bidder's funding position (paragraphs 3.10 to 3.19).

13 **The sale process took longer than expected, and had an operational impact on GIB.** The sale process lasted for nearly 18 months, more than two times the length indicated in planning. The delay was largely due to transaction complexity, including bidder due diligence, corporate restructuring, and an application for judicial review towards the end of the process. In our interviews members of GIB's board told us that this restructuring was not necessary to secure a sale, and that it distracted them from business as usual. However, the GIB Board agreed to continue the restructuring following a special resolution by the Department, as shareholder. The delay and uncertainty also affected GIB operationally and a number of key staff departed. GIB told us this limited its ability to invest and that it had to manage the situation carefully to avoid a more severe impact on the business (paragraphs 3.17, 3.24 to 3.25 and Figure 15).

14 **UKGI achieved an increase in price and GIB secured specific but non-binding commitments from Macquarie around its future.** In December 2016, Ministers and UKGI decided to pause the sale, following which Macquarie increased its offer by £32 million. At the same time the uncertainty and risk to Macquarie decreased, as the construction risk profile changed and power prices increased. Macquarie has made public (non legally binding) commitments for the first three years after the sale, including commitment to GIB's green objectives and the Green Principles. The preferred bidder increased its commitments to the future of GIB owing to the direct intervention of GIB Board, and increased its final offer during the period of negotiation owing to UKGI's actions. However, government actions to meet climate change commitments will extend beyond 2020. For example, the government's Clean Growth Strategy sets out proposals for decarbonising all sectors of the UK economy through the 2020s (paragraphs 3.7, 3.17, 3.19 and 3.21).

15 **GIB's internal valuations showed that its assets under construction could have been worth more when operational, but government wanted to transfer the construction and market risks of holding to the buyer.** The Department, on advice from UKGI, concluded that the risks of a 'phased sale' outweighed the potential benefits when compared with the sale to Macquarie, and effectively took a lower sale price to avoid the risks of waiting. These risks include: construction risks, the risk that an initial public offering might be unsuccessful, the risk that it might be unable to secure a state aid extension, and the need for additional public funding for GIB under the phased sale option. UKGI did not fully value the benefits and risks of its phased sale option until February 2017, after a number of key decisions had already been taken. UKGI estimated in February 2017 that the value of the construction risk foregone by selling then to Macquarie was between £67 million and £98 million (paragraphs 3.5, 3.26 to 3.28 and Figure 16).

16 **UKGI successfully sold a novel and complicated asset and obtained a premium to government's investment.** The sale was complex, involving (at sale launch) an underdeveloped market and 76 individual assets each requiring substantial bidder due diligence. During the sale process the European Union membership referendum result led to a period of uncertainty in capital markets. UKGI sold 100% of the Department's shareholding in GIB and the majority of its assets for a net cash purchase price of £1,621 million. This price represents a £186 million premium over the taxpayer's investment in GIB (excluding estimated financing costs of around £60 million) (paragraphs 3.5 and 3.26).

17 **The Department succeeded in declassifying GIB and most of its assets from the public sector balance sheet.** The Office for National Statistics (ONS) has now declassified GIB from the public sector balance sheet. UKGI has retained a 90% interest in five of GIB's assets which Macquarie had valued at a discount to book value (the value of government's interest is around £132 million). The sale reduces public sector net debt by £1.6 billion, and Macquarie is now responsible for around £500 million of future commitments (paragraphs 3.29 to 3.30 and Figure 17).

Conclusions on value for money

18 The Department set up GIB with a clear mission that provided a sound basis for it to succeed. It quickly stimulated investment in the green economy, particularly in offshore wind where it was addressing market failures and returns on the portfolio are forecast to exceed expectations. However, GIB's impact in other sectors is less certain and in deciding to sell the Department lacked clear criteria or evidence to show that GIB had achieved its intended green impact. The Department nonetheless concluded that market failures had largely been addressed, and decided to sell.

19 The sale was complex and took longer than expected, with the Department's declassification objective creating tensions with the need to secure value for money for the taxpayer. Even so the final sale price was within UKGI's expected valuation range, at the lower end. GIB continues as an institution with private funding and green commitments, but Macquarie has no legal obligation to ensure GIB will keep focusing on its green objectives and be an 'enduring institution' for years to come. Ultimately the value for money of the intervention will only be seen over time. A key test will be whether the government needs to intervene again in this way to stimulate growth in the green economy and to help it achieve its climate change commitments.

Recommendations

20 We recommend:

a When creating companies government should set out the criteria (including suitable comparators, where available) by which it will judge their success compared to their mission and objectives. It should proactively plan, develop and maintain a framework for evaluating performance over time, to inform decisions about future policy.

b When setting up companies, government should ensure their capital structure aligns closely with their objectives, and there are clear arrangements for ongoing financing. The government should be clear about whether it will fund them in the long-term; fund them in the short term then allow the company to borrow; or allow them to sell assets and reinvest.

c When considering whether to sell public assets, government should consider the impact of sales on a range of fiscal measures. Officials should assess explicitly by how much declassification could reduce the potential value for money of a sale, and make this impact clear to decision-makers. As recently recommended in the C&AG's report *Evaluating the government balance sheet: borrowing*, government should use its public sector net financial liabilities (PSNFL) measure to inform its management of the balance sheet, and in particular its approach to asset sales.[1]

d Government should draw on a broad range of analysis when considering an asset sale, and continue to assess this at all stages of a sale process, including:

- Government should consider the timing of sales in relation to the lifecycle of the intervention and assess the likely impact of the sale process, including the potential for unexpected delays, on the operations of the public asset it is selling.
- Government should set selection criteria for asset sales early in the process, which should state explicitly when the "no sale" option will be preferred.
- If a sale option does not meet all of government's objectives but is likely to achieve a higher value than other shortlisted options, a basic estimate should be made of the price achievable. This will allow policy makers to better understand any value for money trade-offs between sale options for a given set of objectives.
- Throughout the process, government should quantify and monetise the risks of different options and explicitly factor this information into its appraisal.

1 Comptroller and Auditor General, *Evaluating the government balance sheet: borrowing,* Session 2017–19, HC 526, National Audit Office, November 2017.