National Audit Office

The creation of the UK Infrastructure Bank

HM Treasury, UK Infrastructure Bank

REPORT

by the Comptroller and Auditor General

SESSION 2022-23
1 JULY 2022
HC 71

We are the UK's independent public spending watchdog.

We support Parliament in holding government to account and we help improve public services through our high-quality audits.

The National Audit Office (NAO) scrutinises public spending for Parliament and is independent of government and the civil service. We help Parliament hold government to account and we use our insights to help people who manage and govern public bodies improve public services.

The Comptroller and Auditor General (C&AG), Gareth Davies, is an Officer of the House of Commons and leads the NAO. We audit the financial accounts of departments and other public bodies. We also examine and report on the value for money of how public money has been spent.

In 2020, the NAO's work led to a positive financial impact through reduced costs, improved service delivery, or other benefits to citizens, of £926 million.

The creation of the UK Infrastructure Bank

HM Treasury, UK Infrastructure Bank

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 29 June 2022

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Gareth Davies
Comptroller and Auditor General
National Audit Office

23 June 2022

HC 71 | £10.00

Value for money reports

Our value for money reports examine government expenditure in order to form a judgement on whether value for money has been achieved. We also make recommendations to public bodies on how to improve public services.

010813 07/22 NAO

Contents

This report can be found on the National Audit Office website at www.nao.org.uk

If you need a version of this report in an alternative format for accessibility reasons, or any of the figures in a different format, contact the NAO at enquiries@nao.org.uk

The National Audit Office study team consisted of:

Simon Banner, Callum Saunders and Nadia Xarcha under the direction of Simon Reason.

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

020 7798 7400
www.nao.org.uk
@NAOorguk

Key facts

£22bn

total capital available for the UK Infrastructure Bank (the Bank) to make investments and issue guarantees

June 2021

Bank "Open for business"

5

number of deals made by the Bank to May 2022

£650 billion	the National Infrastructure and Construction Pipeline projection of expenditure on new projects between 2021 and 2031
£5 billion	European Investment Bank financing in the UK exceeded this level in each of the four years to 2016
14 months	an estimate of how much shorter the planning time was for the Bank's launch, compared with the Green Investment Bank and the British Business Bank
44	number of deals in the Bank's investment pipeline at April 2022
2.5% – 4%	the annual financial rate of return that HM Treasury has set for the Bank to be achieved by the end of 2025-26
272	the number of permanent staff the Bank plans to recruit by September 2023, from a base of eight in April 2022

Summary

1 Good quality infrastructure is essential to deliver services across a range of sectors. Investment is vital to building and maintaining infrastructure; it is also essential where infrastructure needs change, for example to achieve the government's commitment to achieving net zero carbon emissions by 2050. The government's National Infrastructure Strategy highlights the importance of infrastructure to outcomes for consumers, the environment and disadvantaged areas of the country. The government wants private investors to continue playing a key role in financing infrastructure. However, the level of risk, particularly in relation to new technologies or early investment in projects, can deter potential private investors from otherwise attractive infrastructure projects.

2 In June 2021, HM Treasury launched the UK Infrastructure Bank (the Bank) to encourage private finance alongside public investment, to achieve two strategic objectives – helping to tackle climate change and supporting regional and local economic growth. The Bank is a publicly owned company, with HM Treasury as the sole shareholder. UK Government Investments acts as the shareholder representative, including as a member of the Bank's Board. HM Treasury has provided for the Bank to invest up to £22 billion of public money over its first five years, through a combination of equity, loans and guarantees to support infrastructure projects. It has asked the Bank to prioritise five sectors: clean energy, transport, digital, water and waste.

3 In its design, the Bank bears strong similarities with other government interventions, particularly the Green Investment Bank set up to promote green finance, and the British Business Bank established to improve access to finance for smaller businesses. We published reports on the set-up and performance of those companies.[1] The Bank is larger than both of those interventions in terms of public resources to be committed and has, for example, a much broader potential scope than the Green Investment Bank had.

Scope of this report

4 This report covers the Bank's set-up, including HM Treasury's planning before launch. It examines the Bank's progress in implementing HM Treasury's vision for the Bank, in terms of establishing structures and processes to pursue its objectives. It also looks forward to the main challenges facing the Bank, and how the Bank is preparing for them. We did not evaluate the success of the Bank's early investments as part of this study. Our methods are set out in Appendix Two.

1 Comptroller and Audit General, *The Green Investment Bank*, Session 2017–19, HC 619, National Audit Office, December 2017; Comptroller and Audit General, *The British Business Bank*, Session 2019–20, HC 21, National Audit Office, January 2020.

Key findings

Preparing for launching the Bank

5 HM Treasury wanted to launch the Bank quickly and did so, truncating some important elements of the usual process or deferring them until after launch. In July 2018 the National Infrastructure Commission recommended to government the creation of an infrastructure bank by 2021. HM Treasury began planning for the Bank in August 2020, convening a Programme Board to run and oversee the planning process, which at 10 months was around 14 months shorter than the planning time for the Green Investment Bank and the British Business Bank. HM Treasury produced one business case (rather than the usual three), on which it was still working after the Bank had launched. Its options appraisal was mostly qualitative, and we found no detailed analysis in the business case as to how the Bank's available capital (£22 billion) was set, or how the sectors, technologies and investment stages where the Bank could most usefully invest were identified. The Bank launched in June 2021. As HM Treasury had planned, and as outlined in its March 2021 Policy Design document, the Bank launched with a number of aspects still to be settled. This included detailed objectives and performance metrics, staffing and business processes. HM Treasury put in place controls to minimise risks to the taxpayer, such as investment limits (paragraphs 1.4 to 1.6, 1.10, 2.2 to 2.4, 2.8 to 2.12, and Figure 6).

6 In designing the Bank, HM Treasury learned from comparable interventions. The Bank's structure and relationship with government are intentionally similar to other government interventions, particularly the Green Investment Bank and the British Business Bank. We have seen evidence of HM Treasury and the Bank learning lessons from those institutions, for example through involving people with direct experience of them in the planning and implementation processes, and through specific elements designed in response to challenges we had identified in our reports on those interventions. Both the Green Investment Bank and the British Business Bank were launched in shadow-form before going live; however, HM Treasury took the decision to launch the Bank "in operational interim form", increasing the number of tasks to complete once the Bank was "open for business" (paragraphs 1.13, 2.3, 2.4 and 2.9).

Progress since launch

7 **The Bank, with HM Treasury support, has worked hard to build its structures and processes.** A range of important operational framework elements were not in place at launch, for example around people, processes, and technology. At launch, there was a permanent chair and a partial interim board, and by late 2021 HM Treasury had appointed some interim senior executives to the Bank under a permanent chief executive it appointed in September 2021. The Bank has recruited at other levels, and staff numbers have increased from six in June 2021 to 127 in April 2022, relying heavily on interim, temporary and contract staff. While the Bank's first three deals were approved through HM Treasury's existing processes, the Bank has developed processes for encouraging, scrutinising and approving investments. The Bank has developed these, and a suite of governance and risk management approaches, seeking to draw on public and private sector good practice. It currently relies heavily on existing HM Treasury systems – for financial management, for example – but it has in place plans to develop its own technology solutions (paragraphs 2.11 to 2.18 and Figures 7 and 8).

8 **There is more still to do to make the Bank a fully operational organisation.** To be fully operational, the Bank requires a strategy, governance structures and a full suite of product offers including the powers to lend to local authorities. In May 2022, HM Treasury introduced a Bill which when enacted would grant the Bank the full range of powers to fulfil its local authority lending function. In June 2022, the Bank published its first strategic plan. Updated annually, this will set out how the Bank will fulfil its strategic objectives, how it will act in accordance with the operating principles that HM Treasury set for it, and how it will measure its performance and impact. A key element of the Bank's governance – the completion of key Board committees – will only be complete when the non-executive directors whose appointments were announced in June 2022 take up their posts. The Bank has not begun to deliver its function of advising local authorities and is still developing how this will operate in practice. The Bank is deliberately not marketing this function until it is capable of delivering it (paragraphs 2.12, 2.21, 2.24 to 2.26 and 3.6).

9 **The Bank has made some early deals in a measured way, and there appears to be high demand for its investment.** At the end of May 2022, the Bank had made five deals, which are all loans, amounting to £311.5 million.[2] These are not representative of the full range of investment government hopes the Bank will deliver. Although the Bank considers the underlying projects to be more complex than government would typically invest in, the investment structure (loans) of some of the deals are similar to those which other parts of government already make. The Bank has sought to proceed with deals at a pace it is comfortable with, while completing the development of its internal controls and processes, including research skills. It will be some time before these are in place to enable the Bank to make higher-risk equity investments. There were 44 potential deals in the pipeline at the end of April 2022, representing around £5 billion. The Bank will not go ahead with all of these deals but it demonstrates the range of investment opportunities in its priority sectors. The pipeline is developed through a range of enquiries coming in through the Bank's website and existing contacts (reactive), and through market engagement (proactive). The Bank aims to be aware of every major infrastructure deal even if it chooses not to invest (paragraphs 2.27 to 2.29 and 3.15, and Figures 10 to 13).

Future challenges

Continuing the build-out of the organisation

10 **The Bank needs to complete several tasks before the organisation is at 'steady state'.** As outlined in paragraph 8, there are several steps the Bank needs to take before becoming fully operational. These include:

- recruitment of permanent staff at all levels, which will be influenced through its pay and reward offer, although recruitment is also affected by labour market conditions;
- developing its own corporate functions, such as financial management and IT systems so it does not have to rely on HM Treasury systems; and
- developing its systems and processes, to help it identify and manage investments.

The Bank recognises these challenges and seeks to mitigate and manage them through its risk management and other organisational processes (paragraphs 3.3 and 3.21).

2 Five Bank deals had reached financial close by the end of May 2022. Financial close is the point where all project and financing agreements have been signed and financing can be drawn down to commence the project.

11 **The Bank is in the early stages of developing its advisory function, and its approach to engaging with its stakeholders.** HM Treasury said that the Bank's function to advise and support local authorities would be "phased in". The advisory function remains in its early stages as the Bank is still working through, for example, how it will allocate its support fairly and consistently across projects, where it can add value and how it will measure its performance. The Bank has not set a go-live date for the advisory function. The Bank has shared with us a plan for engagement during its next phase, but we have not yet seen plans for how the Bank will assess whether its engagement is working as intended (paragraphs 2.25, 3.5, 3.6 and 3.8).

12 **The Bank's governance structures will need to work effectively to ensure it maintains operational independence and manages investment risks.** HM Treasury has established governance arrangements for overseeing the Bank's activities, and set out clearly which matters are reserved for itself as the shareholder. The Bank and HM Treasury need to ensure this relationship works, to maintain the confidence of private sector investors. As part of the accountability process, the Bank has established clear investment and due diligence processes for individual investment decisions. Many of these due diligence processes, such as legal and financial, are currently outsourced to contractors. As the Bank grows it will need to explore which due diligence functions, if any, will be undertaken in-house. We have not seen any plans for how the Bank will do this (paragraphs 1.6, 2.6, 2.12 to 2.16 and 3.10 to 3.12).

Targeting activity

13 **The Bank will need a detailed understanding of investment needs based on a thorough analysis of the markets it operates in.** HM Treasury's analysis of investment needs, before launching the Bank, was high-level and drew mainly on existing information sources such as the National Infrastructure Commission. By comparison, the Department for Business, Energy & Industrial Strategy (BEIS) had commissioned an 'analysis of needs' before launching the Green Investment Bank. The Bank has undertaken analysis, including market engagement, which informs the assessment in its strategic plan setting out where it considers its investment opportunities lie. Alongside a detailed understanding of investment needs, the Bank requires an impact framework which clearly shows where it can best intervene, and a clear view and messaging of what the Bank's distinct offer is. For example, HM Treasury has set a minimum lending threshold of £5 million for local authority projects to avoid spreading resources across too many smaller transactions, but we have not seen any detailed analysis assessing what different funding levels, regions and project types are most in need of support. This type of analysis is important to ensure that the Bank is effectively targeting its investment, and opportunities are not inadvertently overlooked (paragraphs 2.10, 2.22 and 3.14 to 3.16).

14 **The Bank needs good information to help it manage tensions between its objectives, operating and investment principles.** In addition to setting strategic objectives and operating principles for the Bank, HM Treasury set four investment principles that the Bank must follow in its decisions on individual investments. HM Treasury and the Bank recognise there could be tensions it will need to manage, for example an investment may deliver strong local growth but be harmful to the environment. To mitigate these tensions, the Bank has established investment decision processes that assess the potential impact of each investment against the Bank's objectives. In developing its impact framework, the Bank will need to be clear what an acceptable range looks like for its objectives and principles, and measure performance against these criteria. Over time this information set will offer it a benchmark against which to consider future similar investments (paragraphs 3.18 to 3.20, and Figure 5).

15 **There are things outside the Bank's control which will affect its ability to deliver.** The viability of the project types the Bank intends to invest in depends on macroeconomic factors, for example the revenues that projects can ultimately generate and factors such as supply chains and cost inflation. The Bank's ability to attract private finance depends on the same factors, and also financial market conditions such as the levels of cash available to invest. Public sector investment banks are often expected to be counter-cyclical – that is, to invest in markets when others are withdrawing owing to economic circumstances. While the Bank undertakes some scenario analysis covering demand volatility and investment performance, it does not include impacts of changes in wider macroeconomic variables, such as inflation (paragraph 3.21).

Demonstrating success

16 **HM Treasury has set two high-level objectives and an earnings target for the Bank, but has not specified criteria for judging whether the intervention has been successful overall.** HM Treasury has set the Bank a target of helping to tackle climate change and aiding regional growth alongside earning an annual return on equity of between 2.5% and 4% by 2025-26. The Bank has translated this into a "triple bottom line", delivering: the financial return target; a positive impact on local growth and net zero; and ensuring its investment brings in additional private investment. The Bank has also outlined in its strategic plan how it will use four key performance indicators to appraise the impact of its individual investments on regional growth and net zero, and is aiming to have benchmarks in place for these by December 2022. What we have not seen is the detail of how the Bank will bring this information together with other measures, such as efficiency, to assess performance of the organisation as a whole. The Bank told us it plans to evaluate its activities, but it has not yet developed an evaluation strategy or framework. HM Treasury plans to review the Bank's performance in spring 2024. However beyond the equity target it has not defined specific criteria by which it would judge the success of the Bank (paragraphs 2.14, 3.20 to 3.27 and Figure 5).

17 **The Bank will need to strike a balance between managing costs at a time of pressures on public finances, and recruiting the specialist investment skills it needs to deliver its mission**. The Bank's return target brings together cost and financial return information but does not give information on whether the Bank is operating efficiently – for example, returns at the low end of the range could indicate low investment returns, or operational inefficiency, or both. As a delivery model, creating the Bank is a relatively high-cost option compared with alternatives because of the cost of establishing and operating a separate institution in a sector which attracts higher rates of pay than the public sector. Our analysis of the Bank's budget projections suggests that, compared with the experiences of the Green Investment Bank and the British Business Bank, the Bank will have relatively higher operating costs per employee in its first full year but will be middle-ranking in the subsequent two years. The Bank has commissioned and received external benchmarking of its pay and reward proposal. But we have not yet seen evidence of the Bank planning to benchmark the costs of individual support functions such as HR, or to benchmark the Bank as a whole with suitable comparators, as the British Business Bank has sought to do (paragraphs 2.7, 2.17 to 2.20, 3.23, 3.27, and Figure 9).

18 **The Bank will need to demonstrate that it is adding value to justify its additional costs.** The government wants the Bank to be ambitious in scale and scope. It also wants the Bank to be financially self-sustaining for the long term, through recycling returns from investments. Stakeholders we engaged with also want the Bank to be innovative – taking bold risks that others cannot, or will not. At an organisational level, the Bank needs to take an appropriate risk approach allowing it to deliver on the government's ambitions, while still managing the risks to public money from making available up to £22 billion in investment and guarantees, and ensuring it has the correct skills and experience to maximise returns and minimise losses. To establish credibility and add value, the Bank will need to develop a clear view of things only it can do, and to build its expertise and reputation around these. As it develops its performance measurement framework, it will need to establish indicators that stretch the organisation (paragraphs 3.9, 3.23 to 3.29 and 3.32).

Conclusion on value for money

19 The government wanted to be ambitious in creating the UK Infrastructure Bank, both in the scale of its purpose and the intention that it should start making deals as quickly as possible. Moving at this speed meant some important planning steps were skipped, and many aspects of the Bank's structure and processes were, deliberately, not in place at launch. This is an unusual approach, and HM Treasury took steps to ensure controls existed to protect taxpayers' money. Officials at the Bank, with support from HM Treasury, took a pragmatic approach by progressing new investments at a pace in line with its available resources, while recruiting staff and establishing systems and controls: a trade-off for moving at speed to open the Bank.

20 The Bank, with HM Treasury support, has worked hard since launch to complete the Bank's set-up. Some elements, particularly its advisory function, remain to be established and it will take time for the Bank to fully mature, so it is too early to say whether the Bank will be a success. The Bank will need to manage a range of operational and external challenges if it is to deliver government's ambition for it. It will need to clearly demonstrate its achievements and that it is justifying the costs of establishing the Bank as a separate institution. Drawing together information on costs and impact will be essential in allowing the Bank to demonstrate value for money. Developing a clear view of where investment is most needed, and an impact framework that shows where the Bank's interventions are most effective, will be vital to its future success.

Recommendations

21 We make the following recommendations:

a HM Treasury should confirm by the end of summer 2022 how it intends to conduct a post-implementation review and include in that work an assessment of how the Bank's initial structures are working in practice and whether they are appropriate to the Bank's ongoing role.

b The Bank should, learning from the Green Investment Bank and British Business Bank interventions, further develop its understanding of where infrastructure needs are greatest so that it routinely informs investment decisions and prioritises them. It should bring this understanding of needs together with a clear view of what it can do best, based on its skills and information about its performance.

c In developing its performance measurement framework, the Bank should ensure it has metrics and benchmarks allowing it to assess in detail whether it is balancing all of its objectives and delivering on the government's ambition for it. HM Treasury and the Bank need to develop a more robust plan for evaluating the Bank's activities over the longer term, to help it measure additionality and assess which of its tools are most cost-effective.

d The Bank should benchmark its costs for individual support functions, such as HR, and the organisation as a whole, with suitable comparators. It should work towards bringing together performance and financial information to help it assess its own cost-effectiveness.

e The Bank should develop clear aims for its advisory function and develop measures to help it assess performance over time. It should develop a formal and strategic approach to engagement, including communicating to market participants a clear picture of what the Bank is best placed to do and, correspondingly, what it will not do.

f The Bank should work with central government and other public bodies to structure its engagement, including through formal arrangements where appropriate, to maximise opportunities for co-operation and co-ordination where beneficial and to manage areas of potential duplication.

g The Bank should develop approaches to assessing whether its engagement with local authorities, other stakeholders and the market is working as intended.