UKSIF
UK Sustainable Investment
and Finance Association

23 October 2015

Dr Farrah Bhatti
Energy and Climate Change Committee
14 Tothill Street
London
SW1H 9NB

Dear Dr Bhatti,

Thank you for the opportunity to respond to the Energy and Climate Change Committee's inquiry on investor confidence in the UK energy system. This response outlines the concerns held by the UK Sustainable Investment and Finance Association (UKSIF) and incorporates feedback from our members on the extent to which increased uncertainty around energy policy is undermining investor confidence.

About the UK Sustainable Investment and Finance Association

UKSIF is the membership network for sustainable and responsible financial services in the UK. We promote and support responsible investment and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF has around 240 members and affiliates including financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs. For more information about UKSIF, please visit www.uksif.org.

Overall context

We can assert with confidence that changes to the renewable energy policy framework have served to undermine investor confidence in the UK energy sector and have deterred some investment. It is the role of the Government to provide a stable policy environment to let private capital flow. Since the election there have been several unexpected announcements regarding financial support for renewable energy investment including:

- Ending support for onshore wind under the renewables obligation (RO) a year earlier than expected.
- Removing pre-accreditation for feed-in-tariffs (FITs) for small-scale renewables projects.
- The proposal to exclude new solar PV projects up to 5MW from its grandfathering policy.
- The proposal to close the RO for solar projects up to 5MW a year earlier than expected.
- The proposal to introduce an annual spending cap on FITs awarded to new projects between 2016-2019 (and could be introduced as early as January 2016).
- Removing the exemption for wind, solar and biogas from the Climate Change Levy (CCL).

We acknowledge the Government's priorities of maintaining energy security at an affordable price for consumers, while decarbonising the power system. However we do not accept that these concerns are mutually exclusive from each other. According to the most recent DECC figures, the energy supply sector was responsible for 33% of UK greenhouse gas emissions in 2013 and energy supply sector GHG emissions have fallen 32% since 1990.[1] According to the Department, the decrease resulted '*mainly from changes in the mix of fuels being used for electricity generation, including the growth of renewables, together with greater efficiency resulting from improvements in technology*.' Continued support for the sector is a significant step towards decarbonisation of the power sector which in turn will support the UK in meeting its ambitious 80% reduction target by 2050. The integration of power from clean energy sources also reinforces the electricity network and contributes to increased energy security.

In supporting the transition to a low-carbon economy we require investment now that will have benefits to both consumer costs and efforts to reduce emissions over the long-term. This requires confidence to invest which would be achieved through a long-term policy framework. Our members tell us that one effect of decreased investor confidence is that it has become more difficult to raise the necessary capital, which in turn has raised the cost of that capital. This will have two effects: First it means the transition to a low-carbon economy will become more expensive, and we have known for some time[2] the cheapest and most stable way to make the transition is to do it as early as possible. Second it means that, contrary to the aims of the Government, consumer bills will actually go up.

A recent report by Good Energy[3] has quantified the reduction in wholesale energy prices due to wind and solar power. It emphasised the need to analyse renewable support in net terms. Subsidy schemes are paid for by consumers and increase bills, but renewables also drive down the wholesale cost of electricity and help to decrease bills. It estimated that in 2014 the wholesale cost of electricity was reduced by £1.5bn or 58%. Continued financial support for renewable schemes – particularly solar (which has increased from 96MW In 2010 to over 8,200 in 2015) and wind (the UK has the largest amount of installed offshore wind capacity in Europe with 55% of all installations)[4] is an opportunity for the Government to drive down the wholesale cost of energy while providing increased energy security and helps the UK meet its emission targets.

Where is future investment in the energy sector going to come from? Which types of entities/organisations will invest? What are their criteria for investment decisions?

A change in subsidy schemes will not automatically or considerably alter the types of entity that currently invest. However, one form of investment that has grown since the introduction of the Feed-in-Tariff scheme - and which will almost certainly decline following the changes - is community energy ownership. While still a relatively young sector, community ownership has seen a recent surge due to Government financial support as well as many skilled individuals throughout the UK committing their time and expertise to the creation of valuable community assets. Community Energy England (CEE) recently surveyed 80 community energy organisations and found that Government announcements on renewables, particularly changes to FiTs, are expected to seriously

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407432/20150203_2013_Final_Emissions_statistics.pdf
[2] http://www.parliament.uk/documents/post/postpn318.pdf
[3] Good Energy, *Wind and solar reducing consumer bills: An investigation into the Merit Order Effect*
[4] http://www.ewea.org/fileadmin/files/library/publications/statistics/EWEA-European-Offshore-Statistics-2014.pdf

damage the community energy sector.[5] Those organisations comprise almost 11,000 members and have already delivered 30 MW of renewable energy capacity in 175 separate schemes. Significantly these organisations also planned to deliver 143MW of capacity in 448 new schemes – a considerable amount of which will no longer happen.

The report states that 38 respondents received £7.4 million since 2010 due to the FiT scheme. That has leveraged over £50 million in private investment and generated revenue to local economies of over £45 million. In addition CEE estimate the projects have leveraged over £5 million worth of voluntary professional skills and 88 person-years of voluntary time. Community energy enables individuals to invest in community assets that can clearly be shown to deliver a good return on investment for public money and whose benefits are far wider than simply generating clean energy. Investor and public confidence in the sector have been damaged by the Government's announcements and until costs fall substantially communities will not be able to invest in typical small-scale projects without a reinstatement of financial support from Government.

UKSIF members invest in infrastructure for a variety of reasons. As an asset class it has several appealing characteristics including long-term predictable cash flows which are largely uncorrelated to capital markets. Recently this has been partly due to fixed feed-in-tariffs that have matched the duration and quantum of long-term liabilities of pension funds and insurance companies. As one member said, essential criteria on which investors base their decisions are an analysis of the potential return on investment and the expected risk associated with this return. Investors also look to diversify sources of return across their portfolios and to match assets with liabilities, making infrastructure a very attractive asset class.

In fact over recent years private sector capital and institutional investment funds have become a key source of finance for UK energy infrastructure. According to some estimates this has totalled nearly €4bn in 2014 alone. UKSIF members have argued that while traditionally these projects had been funded by utility companies and Governments, the recent financial crisis has put far more emphasis on institutional financing, and they believe this trend will continue both in the UK and throughout Europe.

Savers' values, particularly with regard to protection of the environment is a consideration that will become increasingly material over the next few years. The introduction of auto-enrolment means that by the end of the decade there will be an additional 9 million savers.[6] In a recent YouGov Poll for Standard Life Investments[7] it was shown that 51% of 18-24 year olds want their money to be invested in ways that minimise environmental damage. It found similar values from 25-34 and 35-44 aged respondents of 47% and 49% respectively. Around 4.5 million of the soon to be automatically enrolled savers are under 40 and clearly environmental protection is an issue that spans age brackets. In further research by YouGov for UKSIF it was shown that 52% of millennials want the option of investing fossil-free and that 43% believe the Government is failing to support renewable energy (45% want to gradually increase their investments in renewables). It is important to understand these are neither niche views nor ones that can be ignored; this is the next generation of savers with very clear social and environmental values and they want to be able to reflect those values in the way they invest. Better communication and instant information has meant that the

[5] http://communityenergyengland.org/wp-content/uploads/2015/10/CEE-Survey-2015.pdf
[6] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/460867/workplace-pensions-update-analysis-auto-enrolment.pdf
[7] Standard Life Investments, YouGov Poll, 2015

finance sector and the way we invest is changing. It is incumbent on the Government, pension providers and fund managers to recognise this and adapt accordingly or they all risk losing out over the long-term.

How does the UK compare with other countries in terms of policy risk?

When investing in infrastructure, policy risk represents an important part of the overall risk equation. This is particularly true of energy infrastructure in all countries. Our members tell us the ideal scenario is one where policy is long-term, predictable and consistent and that any change is gradual. The UK has had a strong track-record in setting public policy that meets most of these criteria.

The UK system already represents best practice in a range of areas, including this consultation process. Our members are concerned by what they perceive to be a departure from an established approach that has proven popular and attractive to institutional investors whose capital the UK needs to continue to attract into its energy and other infrastructure.

Reducing policy uncertainty and increasing investor confidence

The Government should set out at the earliest possible opportunity its long-term energy strategy. It is unfortunate that vitally important decisions relating to the extension of schemes were not taken towards the end of the last parliament, but that only intensifies the need for the current Government to take the initiative and restore long-term policy certainty. In EY's quarterly renewable energy attractiveness index report[8] the UK fell out of the top-10 countries to invest in renewables for the first time in the history of the index. The report established that a significant reason for the fall was due to recent policy announcements on renewables support. It also confirmed the message from UKSIF members that a lack of clarity and direction around UK energy policy may undermine investment in other areas including CCS.

In September 13 investors wrote to the Chancellor to ask the Government to take steps to boost confidence in the UK investment framework.[9] The letter highlighted issues that had caused investors to lose confidence in investment in the sector, in particular the unexpected and quasi-retrospective nature of the announcements. The investors noted the impact the announcements would have on the availability of low-cost capital and argued that the policy changes risk compromising further UK energy investment. They also highlighted the many benefits the UK receives through continued investment in the renewables sector, including increased energy security, reduced exposure to volatile commodity prices and the creation of wealth for a more diverse community of owners beyond utilities.

The signatories to the letter are long-term sustainable and responsible investors who seek to support sustainable economic development and safeguard the environment. With COP21 fast approaching, the imperative to decarbonise the economy is growing. Clearly the role of renewable energy in the future will be increasingly important. It is crucial that the Government focuses on creating the low risk policy environment necessary to ensure the cost of national infrastructure investment remains low. Less than a quarter of the estimated £200 billion required investment in

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[8] http://www.ey.com/Publication/vwLUAssets/RECAI-45-September-15-LR/$FILE/RECAI_45_Sept_15_LR.pdf
[9] http://uksif.org/wp-content/uploads/2015/09/Press-Release-UKSIF-Investor-Letter-to-Chancellor-10-Sept-2015.pdf

the UK energy sector needed by 2020 has been made.[10] The investors made a clear statement that to increase investor confidence in the sector the Government must introduce measures to increase clarity and consistency on the direction of low-carbon energy and set out clearly how it intends to continue down the path of decarbonisation.

The need for clarity in low-carbon policy is something that has recently been underlined by the Committee on Climate Change (the Committee). Its 2015 progress report[11] sets out its views on progress achieved to date and on future progress by the Government in meeting the UK carbon budgets and the statutory target of an 80% reduction in emissions by 2050 on 1990 levels. A stable policy framework is crucial: *'the key risk to future progress is the current uncertainty over the long-term policy framework. Many existing policies or associated funding for the transition to a low-carbon economy are due to end by 2020. There is a need for these to be extended as soon as possible to give confidence to investors and to support low-carbon innovation and consumer choices.'* The Committee stated that the Government needed to extend existing policy approaches and funding commitments into the 2020s. This has not been the case and some of the policies referred to were ended early.

While the UK is currently forecasted to meet its targets for the second and third carbon budgets, the Committee has highlighted concerns over whether progress which has so far been achieved can be sustained into the decades ahead. The committee stated that *'significant action is required in the new Parliament in order to meet the fourth carbon budget and stay on track to the 2050 target.'* Significantly this analysis was published in June, prior to the majority of announcements on renewable energy policy. At that time the Committee argued that many of the low-carbon policies were due to expire over the current Parliament and therefore investors had no certainty beyond the next few years. The result is a lack of efficient investment in low-carbon technologies, many of which have both extensive completion times. In terms of engineering, the long lead times, planning applications, build times and operational lifespans and long-term capital return times, timing is critical[12] and investment is needed now.

The UK's ability to meet the fourth carbon budget has been reduced given the numbers of projects that will no longer go ahead. This was confirmed in the Government's response to the Committee report: *'We know we have a challenge over the fourth carbon budget period (2023–2027) where our emissions are projected to be greater than the cap set by the budget'.*[13] The Government is rightly assessing its approach to a post-2020 framework including levels of support for low-carbon technologies in the power sector and its plan to tackle emissions. We support the Government's goal of a subsidy-free sector, but this will not happen without the extension of the Levy Control Framework. The Committee has recommended the Government set the carbon objective for the power sector in the 2020s and extend funding under the LCF to match project timelines. In addition to this we have received direct feedback from many members that the Government's priority should be to confirm the future of the LCF at the earliest opportunity- our members again underline the UK's need for low-carbon infrastructure and this long-term policy certainty being key to unlocking that investment.

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[10] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/331071/DECC_Energy_Investment_Report.pdf
[11] https://www.theccc.org.uk/publication/reducing-emissions-and-preparing-for-climate-change-2015-progress-report-to-parliament/
[12] http://www.raeng.org.uk/publications/reports/a-critical-time-for-uk-energy-policy
[13] https://d2kjx2p8nxa8ft.cloudfront.net/wp-content/uploads/2015/10/DECC_CCC_Summary.pdf

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The Government intends to make more announcements following the publication of the fifth carbon budget in June 2016 while its proposals on emissions reduction will follow later next year. It has also said it plans to make further announcements following the spending review next month. We would urge the Department to take the Committee's advice and make these announcements as early as possible. The uncertainty created by the changes and the delay in the introduction of replacement schemes and an energy strategy the goes beyond 2020 risks stop-start investment and higher costs as investors look for increased returns to reflect increased risk. As one member told us, acceptable rates of return are largely a function of risk. The lower the risk the lower the acceptable return and the reverse is also true. It is important to note that investor confidence has not just been damaged over the short-term. Several UKSIF members have made the point that confidence is hard won and easily lost; the impact of the changes may be more wide-ranging and long-term than the Government anticipated.

To increase investor confidence we believe the Government should:

- Work on a cross-party basis to establish a long-term UK energy strategy;
- Clarify how DECC will develop the allocation round for support in the current year;
- Clarify that the LCF will continue beyond 2020/21
- Support new disruptive technologies in the capacity market.

We trust our comments are self-explanatory, but if you would like any further clarification, I hope that you will not hesitate to contact us.

Yours sincerely,

Simon Howard
Chief Executive
The UK Sustainable Investment and Finance Association (UKSIF)