Consultation on the Scottish National Investment Bank Bill

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X Yes

☐ No

Scottish Renewables – Scottish National Investment Bank Consultation Response

Scottish Renewables is the voice of Scotland's renewable energy industry, working to grow the sector and sustain its position at the forefront of the global clean energy industry. We represent around 250 organisations across the full range of renewable energy technologies in Scotland and around the world, ranging from large energy suppliers, operators and manufacturers to small developers, installers and community groups, and companies throughout the supply chain.

Our sector is at a critical point. Among our most mature technologies, solar PV and onshore wind have reduced costs in recent years to the point that they are now the cheapest forms of new-build electricity generation[1]. Our level of acceptance and attractiveness to the public is at an all-time high, however the financial support mechanisms controlled by the UK Government which have driven deployment to date have each been abruptly removed or quickly eroded.

Despite energy being a reserved matter, the publication in December 2017 of the Scottish Government's Energy Strategy and its headline target to deliver 50% of Scotland's energy demand from renewable sources by 2030 have offered a strong signal to industry of its commitment to low-carbon energy deployment and the associated social and economic benefits that investment brings.

Among our newer technologies, offshore wind, wave, tidal, bioenergy and heat pumps can all contribute to meeting both the targets within the Scottish Energy Strategy as well as the aims set out in the Scottish Government's Economic Strategy if the conditions for development and growth are right.

Each technology is different in terms of its geographic suitability, scalability, its potential for further innovation and cost efficiency, its commercial position and its possible future application, depending on the development and roll-out of other infrastructure and innovative technologies such as smart systems, energy storage and electric vehicles.

There are some overarching issues which we think are important to highlight in relation to the Bank and its missions which will need to be considered during the governance set up.

Risk Appetite

The Bank will operate in an environment where there are other finance options open to applicants. The key differentiator and reason to have such an institution would be to operate in spaces where the commercial market simply will not fund, or to assess risk differently so as to provide capital at a different cost level.

This would be advantageous for early stage innovation technology investment beyond grant funding to support scale-up from innovation towards commercial scale. In the renewables space this is relevant to technologies such as tidal power or floating offshore wind where the costs to produce energy sit above market rate but are driven down by a process of technology improvement and greater deployment. This is a known cost reduction trajectory followed by both onshore and offshore wind.

The Bank would still presumably need to see a return on investments but, if it is operating in the innovation space, there is a risk that some projects may never return an investment, either because they are competing globally and other countries get to a solution faster or because the project becomes part of the learning cycle of a next phase of development. The success rate may be low but the overall value and impact of successes may be high. Failures will happen first and failures tend to happen more quickly than successes in the innovation space. Experience of our members and other stakeholders with investments in renewables has been that, for every four failures, there was one success. The question is whether the Bank can, whilst being subject to the scrutiny, conditions and accountability that go alongside using public money, take a more flexible approach to innovation

[1] https://www.gov.uk/government/publications/beis-electricity-generation-costs-november-2016

projects and display a higher appetite for risk in order to ensure such investments contribute to broader government agendas.

<u>Additionality</u>

We see the potential for SNIB to consolidate various activities under one roof. While this has many benefits there are funds, such as the Scottish Government's Renewable Energy Investment Fund (REIF), which have provided targeted support to renewables development and we would not want to see that focus diluted. Views from our members indicate that the Scottish Investment Bank is already working effectively and has the potential to expand, so the work of SNIB should seek to build on that and bring additional benefits and outcomes to Scotland.

There are some areas where our members perceive there to be potential overlap, for example with the aims and purpose of the Social Investment Fund. There is a need to avoid duplication or dilution with the SNIB operating alongside other funding mechanisms. Projects should not be in the position of being locked out of a wider funding ecosystem by virtue of being too big for one funding opportunity but too small for another, for example.

We have responded to only those questions in this consultation where we have specific comments or expertise and not commented on those pertaining to issues outwith the scope of our organisation. These issues are of importance to the set up and overall functioning of the Scottish National Investment Bank but are specific to financial governance so we have confined our response to the questions detailed below.

Questionnaire

Question1

Are the proposed objectives and purposes for the Bank the most appropriate to deliver the Implementation Plan's recommendations, and to fulfil the Bank's potential contribution to increasing sustainable economic growth?

Yes, Scottish Renewables agrees that, given the information available, the objectives and purposes are appropriate. We look forward to seeing the detail contained within the Bill when it is published. How these objectives and purposes are met will depend on the assessment mechanism used and a balanced scorecard type approach which acknowledges a number of variables. Reporting of ethical, environmental and social returns could help to build a rounded picture of applications to understand whether they would meet the stated objectives and purposes of the Bank.

Question 2

Do you have views on the statement of the Vision which has been set for the Bank, in paragraph 3.2?

To achieve 'good growth' – that is, growth that will support low-carbon aims and will cover its own costs financially and environmentally, as well as reduce inequality - we need to grow the renewables sector alongside others.

Renewables will power the growth of other sectors in a way that will be more sustainable and inclusive by supporting the development of low-carbon assets and energy generation that is more widely distributed than our current energy system. As part of this, the decarbonisation of our heat supply – in addition to energy efficiency measures – through the roll-out of renewable heat solutions and low-carbon district heat networks in both rural (off-gas) and urban areas will be transformational for communities and businesses across the country.

The renewables sector has already created intense private investment across those technologies with support mechanisms such as onshore and offshore wind. This could be replicated in less established technologies to stimulate growth in these areas such as renewable heat and marine renewables, which can have very targeted geographic and social impacts. We expect to see new applications and technologies come forward but there is still great potential for established technologies such as onshore wind to bring new investment and value through innovation and new smart practices if a route to market could be established.

The Vision is succinct and mirrors the objectives of the Scottish Government's Economic Strategy. There are huge opportunities for Scotland in utilising domestic demand to create a skills and knowledge base in renewables (and other sectors) which is then used to support low-carbon growth elsewhere in the world. There would be a clear advantage to aligning Scottish policy to the portfolio of the bank (where relevant) to ensure scale to support skills and knowledge development as well as using other agencies and institutions to achieve wider aims such as SDI to support the export ambitions outlined above.

Question 3

Do you agree that the overall direction for the Bank should be set by Ministers through a Strategic Framework, including the setting of missions and performance objectives and a target rate of financial return?

There is a benefit to having direction set in a way that would enable the alignment outlined above. Linkages to wider Government policies such as the Energy Strategy are helpful as well as supporting Climate Change mitigation. There are however areas of potential conflict where two objectives in the Vision for the Bank and indeed within Government may clash. Thinking about the need for Government to make use of all assets to support economic growth and balancing that with the other aspects of the vision it is possible that an external factor such as demand/price of oil could present an economic growth opportunity in contention with developing a low-carbon economy. The nature of our North Sea resource means that they may need investment in innovative techniques to maximise recovery in our more marginal zones, but some renewable technologies could also need investment in innovation to reach their future potential. Understanding more of how these types of decisions would be handled by the framework would be helpful.

There are some additional thoughts in our response below about the ethical considerations of the Bank. The approach to the energy mix across the political spectrum has been demonstrated to be different. The renewables sector has seen great policy uncertainty in recent years at a UK level as a result of changes in Government. This has impacted deployment and private sector investment. It would be helpful that while the positive benefits that can come from policy alignment through Ministerial direction are enjoyed, the negative aspects of potential changes in the political landscape are acknowledged and mitigated in order to allow the private sector to have the certainty to invest in areas that are subject to very different political approaches between parties.

Question 4

Do you have any views and suggestions on the example of missions, outlined in paragraph 4.7 and what are these?

The missions are a helpful guiding tool and where we have seen this approach such as with the Green Investment Bank, now Group (GIG), they have had success. That success was not simply around mission however. Success will depend on management, staffing and focus. There were a number of key things which underpinned the success of the GIG including its attractiveness to and use of private sector expertise, its approach in looking for gaps and developing expertise to solve them.

The ability to create and support markets to address the key issues and challenges of our time could be a helpful step to kick start investment and progress as well as getting the solutions required to a point where private sector investment could then meet their needs. This has been seen in renewables where technologies that are considered high risk due to deployment in new locations such as deeper waters/seabed or utilising new technologies have seen high risk premia applied to capital costs which have reduced quickly with deployment. The solutions to the issues identified will be driven by innovation and rely on new methods and processes which will be difficult for traditional finance models to serve. The use of missions offers a longer-term timeframe and adds context which can offer greater certainty.

However, there is a need to consider the ways to measure impacts and whether they would be generated by the applicant, based on existing Government thinking or existing industry research thinking – for example the link between air quality and health is strong but the link between renewables, EVs and health is not yet strong despite it being intuitive. Inclusive growth is another concept that is the subject of debate around measurement so how do applicants determine their contribution to this in order to account for themselves in this mission driven approach?

Heat networks – Heat is a capital-intensive technology and therefore anything that can be done to lower the cost of finance will make more projects viable. As long-term infrastructure project that has few drivers within the current market but huge future impact potential and supports wider SG energy policy aims it could benefit from the approach proposed by SNIB. Various grant funds such as Low Carbon Infrastructure Transition Programme (LCITP) are due to end in 2020, as will other funds drawn from European sources such as those which come to projects through the European Investment Bank. SNIB could potentially fill that gap (left by EU funds) but combine public investment in a way that brings in private money. We are keen to contribute to discussions on how this might be structured.

New buildings – Policy to increase the supply of new and affordable housing doesn't have any low-carbon requirements within it. The SNIB could fund or mitigate the higher upfront costs of heat pumps, recouping the funds slowly and revolving them back out to new projects. This type of investment requires a much longer-term view than is possible even within the public sector because the investment payback is slower and over a longer time frame through reduced operational expenditure and lifetime expenditure.

Costs impacting energy prices - Cost of capital was one of the main drivers of low prices within the offshore wind market. The Contracts for Difference (CfD) processes, which emerged from the UK's Electricity Market Reform, are predicated upon price competition. Aspects of our geography here in Scotland, such as deeper waters offshore and consequently higher transmission charges, make Scottish projects relatively less competitive because the risks attached are perceived and priced higher in capital markets. Some of this can be offset by resource abundance here in Scotland but there are areas where a level playing field on costs is simply not achievable and therefore our ability to compete is impinged. This will reduce our success rate in a system such as CfD and effectively lock away the associated jobs and investment benefits that can be achieved through projects of CfD scale.

Infrastructure investment
The ability to use the SNIB as an agent within wider growth support is essential. Renewables is a global industry and therefore competes on that basis. One area where we will see future global growth in renewables is in the area of offshore fixed and floating commercial wind farms. These are highly complex projects and need specific physical infrastructure to enable them to be delivered within the domestic market and across future export markets. These export opportunities will come through proving competence in a domestic market or early stage market elsewhere but will require concerted effort from other areas of Government and its arms-length agencies. A business case for a very large investment such as port and harbour facilities, or a serial production manufacturing facility may need the projected future revenues from a wider export market to work. This would require a different approach to risk and for resources wider than the bank to be mobilised to support success. It may be that the investment would support more than one sector (for example oil & gas or nuclear new build activity) but be based on an anchor project in the first instance. The mission-based approach could articulate this link at a high level but the process for driving the operational requirements on the ground would need careful thought.

Question 5

Do you agree that the Bank should identify and implement an Investment Strategy, along the lines suggested?

We would agree with this approach, even some of our more established technologies may find that growth or development at the more innovative end will be difficult to finance because of the many variables that impact their risk profile such as the costs of fossil fuels, age and stage of technology, deployment environment etc. Renewables will share this aspect of innovation and the financing of innovative projects with other sectors which can be locked out of finance options if markets tighten because they sit at the edge of the financial markets risk profile. External factors impacting either the risk profile of the rate of return of alternatives can dramatically change the availability of finance. This will change almost constantly with the markets but technologies and processes that sit at the very edge may well become unviable if costs of capital change.

There are also some Scotland-specific issues to consider here in terms of capital costs and projects viability. Reduced costs of capital were instrumental in seeing low prices come through the most recent CfD auction. The ability for projects to deliver at these prices is contingent on a number of geographic factors including the depth of water where projects are to be deployed. If Scotland has aspirations to exploit its naturally deeper waters these projects may require different types of financing to succeed in a system that is pushing towards a lowest cost option. SNIB could deploy capital in such a way that would help level the playing field for projects here in Scotland that may be subject to higher costs and therefore be disadvantaged within a competitive system. The future benefits of growth of skills, expertise, exportable knowledge would be critical reasons to make such an intervention.

Question 6

Are there any arrangements or requirements not already considered that would strengthen and enhance the Bank's ethical approach to investment, and what are these?

We would actively support the Bank itself leading by example in terms of diversity and inclusion. It should be that all sectors are on a continual drive for both these aspects to their operation and governance. Some sectors will move faster than others and rather than set rigid targets for those eligible to apply for investment it would perhaps be more productive to understand the progress, merits and aspirations of each sector/project relative to its current state. This would mean that sectors which have a greater distance to travel in some areas such as diversity and inclusion have a positive incentive to improve rather than being ruled out altogether and therefore having no incentive to progress more quickly.

To alleviate issues identified above the bank could consider parameters to solidify its mission-based approach. Could it for example prevent high carbon investment in order to drive this across the entire portfolio?

Question 7

Do you agree with the principles approach that is proposed for the Bank, including publication of an Ethics Statement by the Board?

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Question 8
Is there a better option than the Public Limited Company model, and if so what is it and why?

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Question 9
Do you have views at this stage on the proposals for capitalisation of the Bank?

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Question 10
Do you have views on how the governance and classification of the Bank should evolve over time, and if so, what measures and protections should be included now to guide and inform a future change in governance and classification of the Bank?

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Question 11
Do you agree with the proposed approach to the Bank's governance and Board arrangements which will inform the Bill, the Articles of Association and a Strategic Framework document?

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Question 12
Do you have any comments on the need for the Bank to have Delegated Powers, in order to achieve the aim of it being operational and administratively independent?

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Question 13
Do you have views on whether and how an Advisory Group could provide advice to Ministers on issues relating to the Bank?

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Question 14
Do you have views on the initial operating model and costs identified in the Implementation Plan and what are these?

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Question 15
Do you have views on any criteria for the approach to remuneration for senior and specialist roles in the Bank?

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Question 16
Do you have views on areas where the current approach to public sector pay would suit the needs of the Bank, are there other examples of variations in public pay policy that would be suitable for the Bank and any areas where some changes may be needed?

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