Northern Ireland Assembly

Research and Information Service Briefing Paper

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Public Finance Scrutiny Unit

Draft Budget 2015-16: Infrastructure Investment

Paper 4 of 5

As part of the five-part series on the Draft Budget 2015-16, this Briefing Paper seeks to explore key aspects of the proposed Northern Ireland Investment Fund, including both Financial Transactions capital and the European Investment Bank, as outlined within Section 4 of the Draft Budget 2015-16 document.

Key Points

- There is currently £35 million of Financial Transactions capital (FT capital) unallocated for the 2014-15 financial year.
- Currently £115.6 million of FT capital is allocated to projects for the 2015-16 financial year. However, the Minister of Finance and Personnel has stated that a number of these projects “require further refinement.”[1]
- It is not immediately apparent how depositing FT capital with the European Investment Bank (EIB) would comply with the rules around the use of Ft capital.
- Furthermore, given the facts currently known it remains unclear as to how the proposed Northern Ireland Investment Fund could negate the need to surrender unused FT capital funding to Treasury.
- The Minister of Finance and Personnel has stated that the feasibility study for the proposed Northern Ireland Investment Fund will include an investment strategy. However, it is not obvious as to how this new strategy will relate to the current Investment Strategy for Northern Ireland.

[1] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (accessed on 6 Nov 14)

Introduction

This Briefing Paper is the fourth in a five-part series that covers key issues arising out of the Draft Budget 2015-16. The series is not intended to exhaustively address the full implications of the proposals: much of the detail that will inform impact is still to follow in terms of how each department will implement the proposals. Also, the timetable for the Assembly to scrutinise and debate the Draft Budget is extremely tight.

With these two factors in mind, and the desire to facilitate Members' participation in the Assembly's on-going discussions and deliberations about the Draft Budget 2015-16, the series addresses key issues that appear to have raised particular interest. The series complements the Lines of Questioning Briefing (NIAR 753-14, dated 4 November 2014) by the Public Finance Scrutiny Unit (PFSU) within the Research and Information Service (RaISe).

In light of the Draft Budget's focus on infrastructure investment, this Paper seeks to explore key aspects of the proposed Northern Ireland Investment Fund detailed within Section 4 of the Draft Budget 2015-16 document.[2] The Paper is presented as follows:

- Section 1 outlines background information regarding Financial Transaction capital and the European Investment Bank, which aid understanding of the proposed new Fund;
- Section 2 highlights key aspects of the proposed new Fund, setting out scrutiny points to facilitate the Assembly's consideration of the Fund; and,
- Section 3 provides some concluding remarks.

[2] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (accessed on 10 Nov 14)

1 Background information

Basic knowledge of Financial Transaction (FT) capital and the European Investment Bank (EIB) is essential to understanding the proposed new Investment Fund. The following two sub-sections outline key information about both. Thereafter, section 2 of this Paper sets out the new Fund proposals. Included throughout are scrutiny points to facilitate the Assembly's deliberations on the Draft Budget.

1.1 FT capital

The United Kingdom (UK) Government introduced FT capital "*as an additional type of capital funding to help boost investment*."[3] The Department of Finance and Personnel (DFP) stated that FT capital:

> *can stimulate private sector investment in infrastructure projects that benefit the region, over and above the level of level of investment made by the Executive from its normal Capital DEL budget.*[4]

The distinguishing feature of FT capital is that funds may be deployed only as a loan to, or equity investment in, a private sector entity.[5] The funding is then used by the private sector to invest in related infrastructure, which is consistent with, and supportive of the Executive's overall strategic aims and objectives.

All FT capital schemes are required to comply with the following conditions:

1. The capital project should deliver policy objectives and be suitable for delivery by the private sector;
2. There is a private sector entity for the department to lend or invest in; and,
3. The sponsor body must have the requisite legislative authority to enter into this type of transaction.[6]

1.1.1 FT capital – Policy Lending

DFP's overview of FT capital makes an explicit link between FT capital and the concept of policy lending. It defines Policy lending as:

> *transactions in financial assets, such as loans and shares, which are acquired to further the policies of a department.*[7]

It goes on to state that:

[3] Email to RaISe (13 Feb 2014): Information supplied by DFP, 13 Feb 2014. Page 2.
[4] Email to RaISe (13 Feb 2014): Information supplied by DFP, 13 Feb 2014. Page 2.
[5] Defined by ONS classification and includes charities and universities.
[6] Email to RaISe (6 Feb 2014): Information supplied by SIB, 6 Feb 2014 Page 2.
[7] Email to RaISe (13 Feb 2014): Information supplied by DFP, 13 Feb 2014. Page 2.

> *Policy lending increases fixed assets on the departmental balance sheet but is not an item in net investment. [ ] it may increase the overall stock of financial debt, as measured by the aggregate Public Sector Net Debt (PSND)*[8]

1.1.2 FT capital and End-Year Flexibility

There are separate End-Year Flexibility (EYF) arrangements in place for FT capital, which allow for the limited carry forward of unspent funds:

> *This flexibility allows for 20% carry forward of unused Financial Transactions Capital funding from 2013-14 into 2014-15 and 10% from 2014-15 into 2015-16.*[9]

DFP recently stated in evidence to the Committee on Finance and Personnel (CFP) that approximately £35 million of FT capital was currently unallocated for the 2014-15 financial year.[10] DFP went on to state that it is reasonably confident that no FT capital will need to be surrendered in the current financial year.

In addition to the unallocated funds for the current year, the Minister of Finance's statement on the Budget identified that:

> *A total of £115.6m of Financial Transactions capital has been allocated to departments for projects involving loans to, or equity investment, in the private sector. A number of these projects require further refinement and this position will be revisited at the final Budget Stage.*[11]

More detailed information on FT capital is provided in RaISe's Briefing Paper NIAR 082-14.

Scrutiny Point:

Given the £35 million of FT capital currently unallocated in this financial year, what assurance can the Executive give that no FT capital will be surrendered in the current financial year?

1.2 EIB

The EIB is owned by the European Union Member States and represents their interests. The EIB's core activity is:

[8] Email to RaISe (13 Feb 2014): Information supplied by DFP, 13 Feb 2014. Page 2.
[9] Email to RaISe (13 Feb 2014): Information supplied by DFP, 13 Feb 2014. Page 4.
[10] Official report of CFP Meeting (2014), available online at http://data.niassembly.gov.uk/HansardXml/committee-10441.pdf (accessed on 11 Nov 14)
[11] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (accessed on 6 Nov 14)

> *to support sound investments. The EIB contributes through "lending, blending and advising": that is providing finance, complementing EU finance and giving advice on programme or project design.*[12]

The EIB's mission is set out in Article 309 of the Treaty on the Functioning of the European Union (TFEU), which states that:

> *The task of the European Investment Bank shall be to contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank shall, operating on a non-profit-making basis, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy:*
>
> *(a) projects for developing less-developed regions;*
>
> *(b) projects for modernising or converting undertakings or for developing fresh activities called for by the establishment or functioning of the internal market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States;*
>
> *(c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States.*
>
> *In carrying out its task, the Bank shall facilitate the financing of investment programmes in conjunction with assistance from the Structural Funds and other Union Financial Instruments.*[13]

1.2.1 EIB Lending Products

Lending accounts for 90% of the EIB's total financial commitment.[14] Its lending products include:

- Project Loans;
- Intermediated Loans
- Project Bonds
- Flexible SME Funding - JEREMIE

Details of each of these products are detailed in Appendix 1 to this Paper.

[12] EIB (2012) The Governance of the European Investment Bank available online at http://www.eib.europa.eu/infocentre/publications/all/governance-of-the-eib.htm (accessed on 5 Nov 14)
[13] EIB (2012) The Governance of the European Investment Bank available online at http://www.eib.europa.eu/infocentre/publications/all/governance-of-the-eib.htm (accessed on 5 Nov 14)
[14] EIB Products: Lending, blending and advising :http://www.eib.org/products/index.htm

More detailed information on the operation of the EIB is contained in RaISe's Briefing Paper NIAR 219-014.

2 Proposed Northern Ireland Investment Fund

On 3 November 2014, the Minister of Finance and Personnel made a statement on the Executive's Draft Budget 2015-16. The statement proposed the establishment of:

> *A Northern Ireland Investment Fund to support investment in local infrastructure. This fund may utilise some of the Financial Transactions Capital funding available to the Executive in 2015-16. It would also potentially allow large international investors, including the European Investment Bank, to invest in local projects that would usually be too small in scale to access this type of finance.*[15]

The Minister stated that:

> *I anticipate that the creation of this Investment Fund, will in the first instance, make a further £1 billion available for investment in infrastructure across Northern Ireland.*[16]

In his response to a question about the Draft Budget, the Minister stated:

> *this was the origin of the investment fund, [ ] there was a need to find a vehicle into which we could put FT capital. That would be somewhere that was off the public sector balance sheet but could still invest in significant infrastructure projects. This is the vehicle that, I think certainly in the next financial year and beyond, we will be able to deposit significant amounts of cash into and, in the process, give cheap money for infrastructure projects in housing or renewable energy.*[17]

He further noted in his statement that:

> *A total of £115.6m of Financial Transactions capital has been allocated to departments for projects involving loans to, or equity investment, in the private sector. A number of these projects require further refinement and this position will be revisited at the final Budget Stage.*[18]

The Minister went on to state that:

> *As a first step in the process I have commissioned a study into the feasibility and extent of this Fund which I envisage will take 4-5 months to*

[15] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (accessed on 6 Nov 14)
[16] http://www.dfpni.gov.uk/draft-budget-for-2015-2016.pdf (accessed on 7 Nov 14)
[17] Official Report 3 Nov 14 http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/3&docID=212321 (accessed on 7 Nov 14)
[18] http://www.northernireland.gov.uk/draft-budget-2015-2016.pdf (accessed on 6 Nov 14)

complete. This will inform the scope, scale, design and investment strategy of a potential Fund This will include determining realistic and deliverable investment need and demand, an appropriate investment strategy and delivery options to meet the Northern Ireland Executive's objectives.[19]

Further noted:

If we have advanced the feasibility study to a sufficient point in this financial year, it is possible that we may be able to use some of the unspent £35 million of FTC and deposit it with the European Investment Bank for the investment fund in advance of it starting to work next year.[20]

Simply stated it is intended that the proposed new Fund will use FT capital to leverage additional funding from the EIB, with the investment negating the need for unused FT capital to be surrendered at the end of the financial year. Key considerations arising from the above proposal are outlined below. They are intended to facilitate the Assembly's scrutiny of the new Fund.

Scrutiny Points:

1. How much FT capital funding is currently allocated to projects that "*require further refinement"* in the 2015-16 financial year?

2. What is the likelihood that those projects will come to fruition in 2015-16?

3. If they do not, what contingency plans are in place to reallocate the resultant unallocated FT capital funds?

4. Given the potential for FT capital to contribute to an increase in overall financial debt for Northern Ireland, what steps has the Minister of Finance and Personnel put in place to ensure that the overall level of borrowing in Northern Ireland remains within manageable limits?

5. In light of the requirement for FT capital to be deployed as a loan or equity investment in a private sector entity, how would investment in the proposed Fund operate?

6. Given the structure and ownership of the EIB, how will the depositing of FT capital funds comply with the rules governing their use, i.e. that investment must be with a private sector entity?

7. Given the range of EIB financing products available, how will the Executive ensure that the department concerned gives due consideration to them and identifies the product that is most suitable for use with the new Investment Fund?

[19] http://www.dfpni.gov.uk/draft-budget-for-2015-2016.pdf (accessed on 7 Nov 14)
[20] Official Report 3 Nov 14 http://aims.niassembly.gov.uk/officialreport/report.aspx?&eveDate=2014/11/3&docID=212321 (accessed on 7 Nov 14)

8. Has the Executive received assurance from Treasury that depositing FT capital with the EIB in a specific year negates the need for unused funds to be surrendered?

2.1 The role of the Strategic Investment Board

Additional considerations arise from the proposed new Investment Fund and the current existence of the Strategic Investment Board (SIB), which in 2003 was tasked:[21]

- *to prepare and oversee the **Investment Strategy for Northern Ireland (ISNI)**, the Executive's 10-year plan for infrastructure investment across the region, and advise Ministers on effective implementation;*
- *to **support the procurement and delivery of major projects** and programmes at the request of sponsoring departments in order to help accelerate delivery timetables and obtain better value for the taxpayer; and*
- *to **foster reform** in systems and processes across the public sector through investment in better infrastructure.*[22]

As noted above, the SIB is responsible for preparing and overseeing the existing Investment Strategy for Northern Ireland (ISNI). SIB undertook a public consultation on the current strategy, which runs between 2011 and 2021.[23]

Scrutiny Points:

1. Is SIB undertaking the feasibility study for the proposed new Investment Fund?
2. Why is it necessary to create this new Fund, given the existence of ISNI 2011-2021?
3. Does its creation represent a duplication of effort and an inefficient use of resources?
4. If it is deemed necessary, how does the Executive envision this new Fund existing alongside the ISNI 2011-2021?
5. Given that ISNI 2011-2021 underwent public consultation, will the new Fund proposals, including the feasibility study findings, undergo public consultation? If so, how is such consultation envisioned?

[21] SIB (2014) available online at http://www.sibni.org/sib_annual_review_2005-06.pdf (accessed on 10 Nov 14)
[22] SIB (2014) available online at http://www.sibni.org/index/about_sib.htm (accessed on 6 Nov 14).
[23] SIB (2014) available online at http://www.sibni.org/investment_strategy_for_northern_ireland_2011_-_2021.pdf (accessed on 6 Nov 14).

3 Conclusion

In his statement on the Draft Budget, the Minister for Finance and Personnel argued that in the given circumstances, the Executive's proposals were best for Northern Ireland. He stated:

> *When faced with tough choices, by backing health, education, jobs and investment in infrastructure we have made the right choices and chosen the best interests of Northern Ireland.*[24]

To ascertain whether these choices are right, this Paper facilitates scrutiny of the Draft Budget's proposals that focus on infrastructure investment. It includes background information to increase understanding of the proposed new Investment Fund's reliance on both FT capital and the EIB. However, given the limited available information at this time, a number of key considerations arise from the proposed new Fund about its reliance on FT capital FT capital and the EIB and require clarification before the Assembly is in a position to properly deliberate on the proposed Fund.

[24] http://www.dfpni.gov.uk/draft-budget-for-2015-2016.pdf (accessed on 7 Nov 14)

Appendix 1 European Investment Bank – Lending Products

Project Loans[25]

The European Investment Bank lends to individual projects for which total investment cost exceeds €25 million. Project loans cover up to 50% of the total capital investment, but average out at around 33%.[26] Interest rates can be fixed, revisable or convertible.[27] Additionally the EIB may charge fees for project appraisal or legal services. Loans repayments are normally annual or bi-annual. However, grace periods for capital repayment may be granted for the duration of the project's construction phase.

The EIB can also provide a single "Framework Loan" which funds multi-component, multi-annual investment programmes for national or local government projects, focussing on improving infrastructure, transport, energy efficiency or urban renovation.

Intermediated Loans[28]

The EIB can make loans to local banks: these *intermediary* banks subsequently provide finance for up to €25 million per project.[29] The size, duration and structure of the loans can be flexible. Intermediaries (local banks) retain the financial risk of the on-lending and retain lending decision making rights. EIB has no contractual relationship with the final beneficiary of the loan.

Project Bonds[30]

The EIB and the European Commission (EC) are currently piloting a *Europe 2020 Project Bond Initiative* to assist companies involved in infrastructure projects (usually public private partnerships). This initiative seeks to attract additional private finance from institutional investors such as insurance companies and pension funds. Its pilot phase is due to end in 2016 and is funded by the re-deployment of €230 million unused EU budgetary resources.[31]

Under the initiative, the EIB provide enhanced credit ratings for companies which issue project bonds that are underpinned by EIB. The EIB provide either a loan or a credit line for companies called a *Project Bond Credit Enhancement* (PBCE). The PBCE provides investors with confidence and security by giving a financial backup or contingency to the project. To date, the EIB Board has approved nine energy and transport projects eligible for PBCE - arising out of six EU countries.[32]

[25] This sub-section relies on information supplied by EIB at: http://www.eib.org/products/loans/index.htm
[26] EIB Project Loans: http://www.eib.org/products/loans/index.htm
[27] Convertible Interest Rates allow for a change of rate formula during the lifetime of a loan at predetermined periods.
[28] This sub-section relies on information supplied by EIB at: http://www.eib.org/products/intermediated/index.htm
[29] EIB Intermediated Loans: http://www.eib.org/products/intermediated/index.htm
[30] This sub-section relies on information supplied by EIB at: http://www.eib.org/products/project-bonds/index.htm
[31] Europe 2020 Project Bond Initiative: http://www.eib.org/products/project-bonds/index.htm
[32] Europe 2020 Project Bond Initiative: http://www.eib.org/products/project-bonds/index.htm

Flexible SME Funding[33] - JEREMIE

A further type of EIB financing relating specifically to SMEs is the Joint European Resources for Micro to Medium Enterprises (JEREMIE) programme. JEREMIE is a joint initiative between the EIB and EC. It is funded mainly through the European Investment Fund (EIF). Member States and regional authorities can opt to use money from EU Structural Funds in the form of market-driven financial instruments instead of offering grants. A major advantage of this is that unlike grants, which can only be spent once, a pool of funds can be re-invested several times. Support is provided to selected local financial intermediaries via national or regional governments.

The JEREMIE programme has access to the following financial instruments:

- Guarantees, co-guarantees and counter-guarantees;
- Equity guarantees;
- Micro-loans;
- Export-credit insurance;
- Securitisation;
- Venture capital;
- Business angel matching funds; and,
- Investment in technology transfer funds.

There are currently four JEREMIE programmes operational in the UK. The table below provides a brief description of the main activities of each programme.

Figure 2: JEREMIE Programmes in the UK[34]

Programme Title	Main Activities
North West Fund	Provides debt and equity finance from £50,000 to £2m to small and medium sized businesses based in, or relocating to, the North West of England.
Finance Yorkshire	Offers business loans and equity-linked finance from £15,000 to £2m for businesses in or relocating to the Yorkshire and the Humber region
North East Finance	Provides debt and equity finance from £1,000 to £1.25 m to SMEs based in, or relocating to, the north east of England, with the aim of helping them to start up, develop or grow.
Finance Wales	Provides debt and equity finance to SMEs in Wales.

[33] This sub-section relies on information supplied by EIB at: http://www.eib.europa.eu/products/jeremie/index.htm
[34] Table produced by RaISe relying on data supplied by UK Department for Business, Innovation and Skills at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/192618/bis-13-p176b-sme-access-to-finance-measures.pdf