



# Where is the Money Coming From?

**James Wardlaw**  
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# Funding vs. Financing

## ■ Funding

- Only 2 sources: customers and Government (backed by same customers' taxes and ability to borrow)
- Fundamental source of resources
- Without adequate funding, financing not possible

## ■ Financing

- Supply adjusts point in time when capital is available to spend
- Can come from a number of sources:
  - Insurance companies
  - Pension funds directly and indirectly through Infra Funds
  - Banks

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**Financing cannot solve a funding problem**



# Insurance Companies

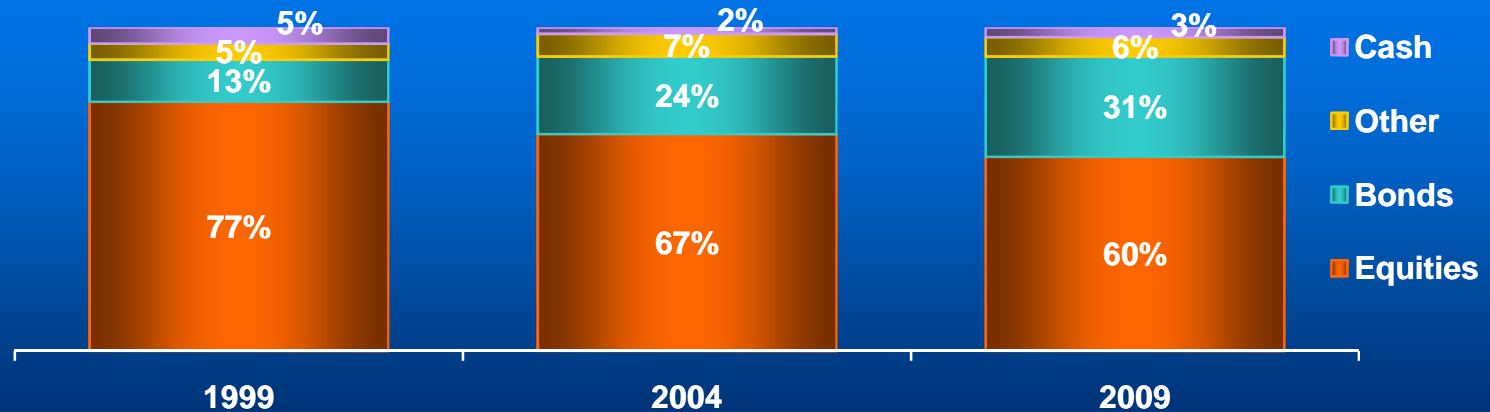
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- Significant annuity liabilities which provide income to UK pensioners
- Seek long term, income producing assets in form of credit investments
  - Annuitants cannot cancel their policies
  - Currently c. 25% of £ corporate bond market and >1/3 at long end
- Lack of corporate bond supply is encouraging them to invest in non-£ assets
- Solvency II impact not clear – generally driving insurers away from equities and into investment grade bonds
  - But not project debt

# Pension Funds

- Defined Benefit (DB) plans have structural need for long duration, inflation linked assets to match liabilities
- DB schemes are closing fast and employers shifting to DC but stock of DB funds in UK is still huge
- DB plans are de-risking and putting less into return seeking' investments (which includes infrastructure equity) and more into bonds
  - Increasingly concerned about liquidity and locking away funds

## UK Pension Asset Allocation



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# Infrastructure Funds

- Essentially, pooling vehicles for pension funds in sector
  - Logical source infrastructure assets are typically large and lumpy. Therefore, building a diversified pool of assets is difficult
- With very few exceptions, infra funds don't want Greenfield risk
  - Want operational assets providing cash on cash yield
- If anything, infra funds have become more conservative in their investment philosophy since Financial Crisis

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# Marguerite Fund

## 2020 European Fund for Energy, Climate Change and Infrastructure

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- Founder shareholders are continental European state development banks – HMG declined to participate
- Targeting €1.5bn equity fund
- Core is greenfield – must be >65% of Fund
- 20 year term
- Target return ~ 10-14% IRR to investors
- Minimum investment €10m. Maximum ~10% of fund size
- Not more than 20% in any one country
- Expected deployment of funds
  - Transport 30-40%
  - Energy 25-35%
  - Renewables 35-45%



# Banks

Essential part of financing mix because they do understand Greenfield project risk.

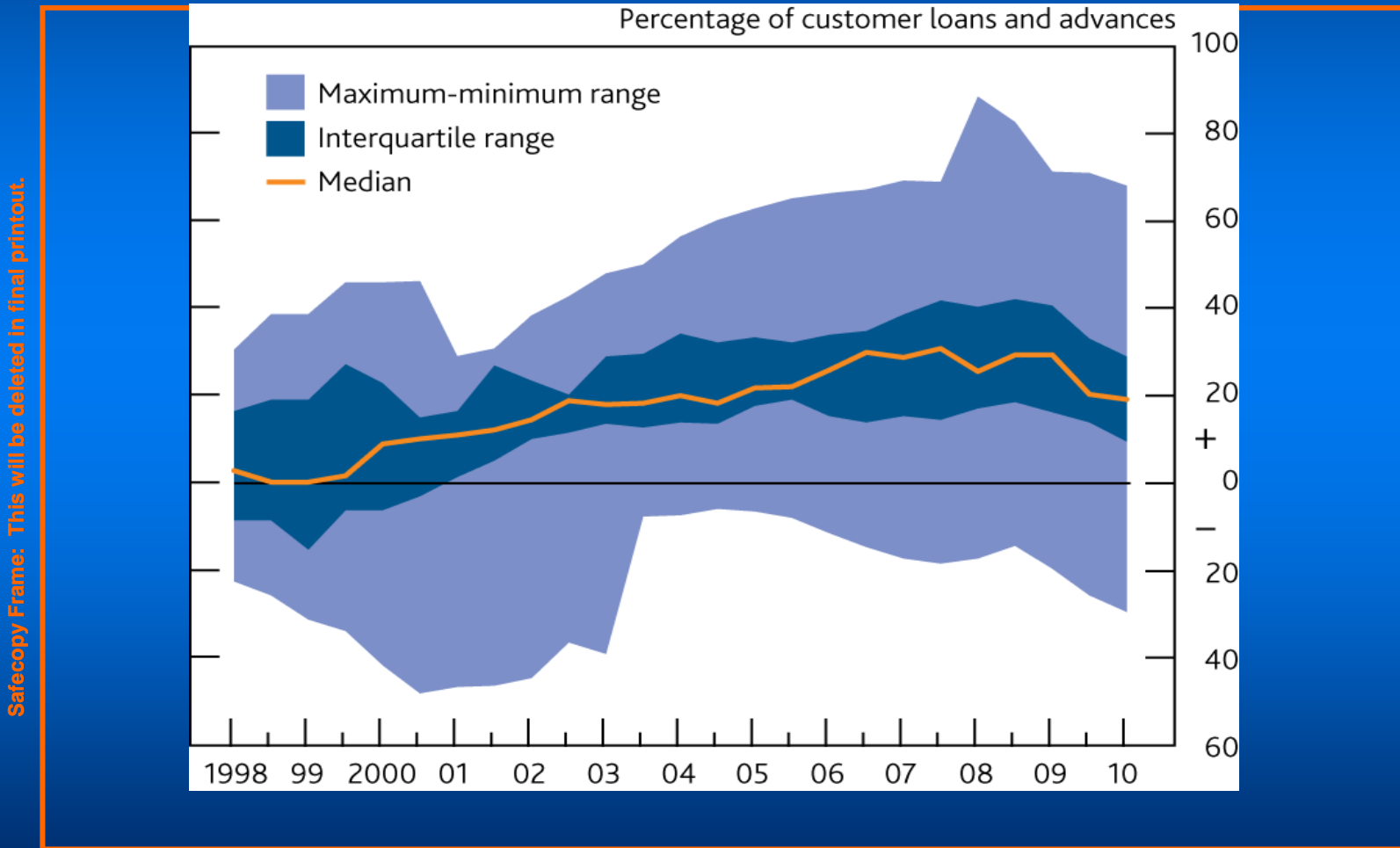
But, still lots of constraints:

- Deleveraging
  - Average UK bank assets down from 30x capital to c.19x, according to Bank of England
- Accounting
  - Can't sell assets on banking books without taking a mark on loss which would impair capital
  - Why? Current margins higher than loans booked in 2005-2007, which means mark to market value is lower than par value
- Customer funding gap
  - Where is going to come from? Same institutional investors being asked to fund Gilt borrowing programme and finance an infrastructure programme!

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# Customer Funding Gap - £475bn end 2009

## £750-800bn to be refinanced/replaced by end 2012



Customer funding gap is customer loans less customer deposits, where customer refers to all non-bank borrowers and depositors.

Source: Dealogic, published accounts and Bank calculations



# Term Structure of Wholesale Funding

## 44% of wholesale funding <3months maturity

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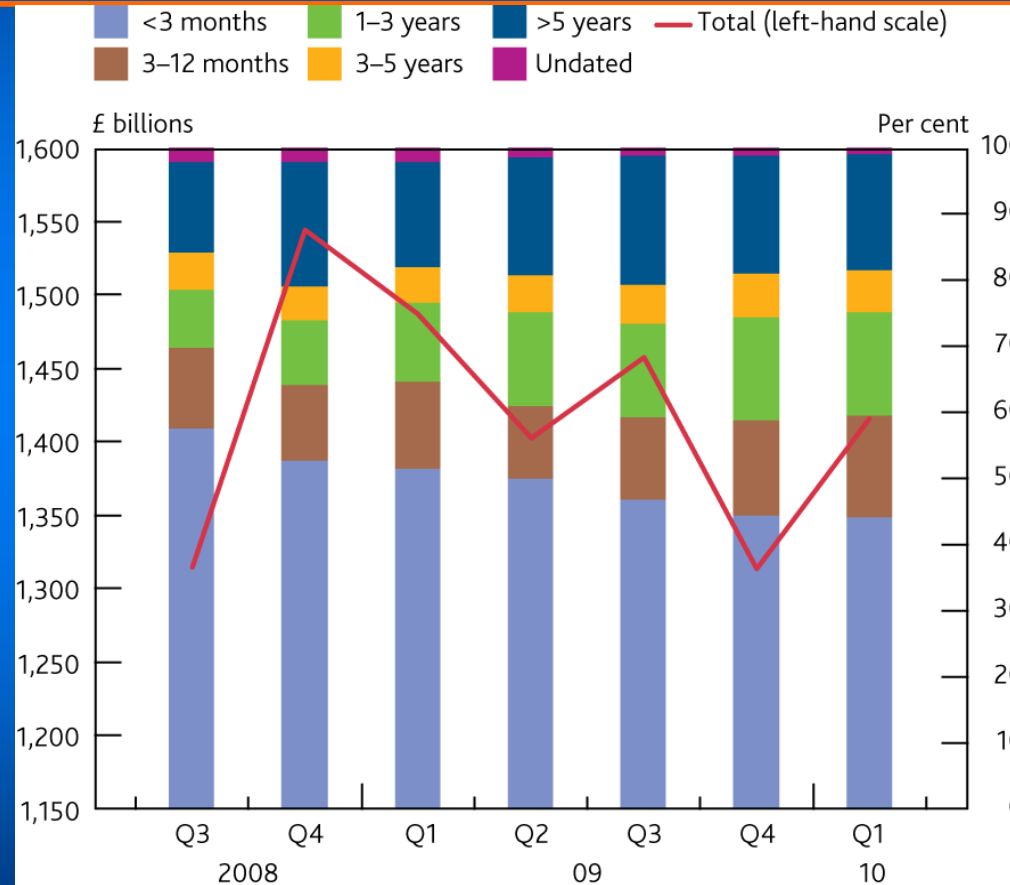


Chart shows data for a subset of the major UK banks peer group — Banco Santander (Santander UK only), Barclays, HSBC, Lloyds Banking Group, National Australia Bank (Clydesdale only) and RBS. Includes bank deposits, OFC deposits, debt securities and subordinated liabilities. Excludes repos.

Source: FSA regulatory returns and Bank calculations



# Banks

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- Don't see UK banks being significant net financiers of infrastructure
- New lending likely to remain focused on 3-5 year maturities with expectation of capital markets refinancing post completion
- 25/30 years bank loans commitments at double digit margins
  - Great while it lasted but mispriced risk ... and capital
- Significant new lending to renewable energy sector is effectively predicated on ability to sell/free up balance sheets
  - onshore wind loans typically comprise 90-90% of renewables lending books



# So Who is Going to Finance New Greenfield Projects?

- Key to getting an effective financing process is to recycle existing loans out of banks and into institutional investors through capital markets once assets are operational
- This will then allow banks to lend more to early stage projects including at community level
- Role of Green Investment Bank
  - Recycling capital
  - Acting as catalyst for attracting private sector capital for projects alongside public sector or GIB money
  - Aggregate project risk and fund with GIB Green Bonds
  - Think of GIB as co-financier/partner as you develop projects

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