The Impact Investing Institute's response to the Left Behind Neighbourhoods APPG's call for evidence on the Levelling Up White Paper

23 January 2023

1. ABOUT US

The Impact Investing Institute was launched in 2019 with a simple mission: to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally. Our aim is for capital markets to be fairer and work better for people and the planet, in order to deliver sustainable and inclusive economic growth.

We are an independent, non-profit organisation, which brought together two influential initiatives: the Government's Taskforce for Growing a Culture of Social Impact Investing in the UK, and the UK National Advisory Board on Impact Investing. We are part of the GSG – the Global Steering Group on Impact Investing Network, which brings together leaders from finance, business, and philanthropy to contribute to solving some of the world's most pressing social and environmental challenges. Our Theory of Change describes how we plan to achieve change in the short-, medium- and long-term. We run a series of research, education and advocacy programmes designed to bring about the market conditions to enable impact investing to flourish.

We are responding to this call for evidence because, given the scale of the challenge as well as the UK's constrained public finances, 'levelling up' will require utilising private capital for public priorities. This is particularly true for the following 'Levelling Up Missions': living standards (1), transport infrastructure (3), digital connectivity (4), skills (6), pride in place (9), housing (10) and local leadership (12). Our place-based impact investing (PBII) programme therefore frames the involvement of private finance in regeneration and community wealth creation in a new way. Below, we outline how central and local government can most effectively utilise PBII to level up the UK.

2. KEY RECOMMENDATIONS

2.1 Clarifying fiduciary duty

We were pleased to inform the Levelling Up White Paper's recommendation for a 5% local investment target for the Local Government Pension Scheme (LGPS), which could catalyse £16bn to kick start growth in places across the UK. We have worked with leading law firms to publish a paper that explains how impact investing (including place-based impact investing) can help pension schemes manage the risks and opportunities presented by environmental, social and governance factors, and therefore deliver on fiduciary duties. Subsequently, through consultation with a range of UK pension schemes, we developed our Impact Investing Principles for Pensions, which have mobilised more than £20bn of assets, plus a range of investment consultants, to commit to embed an impact investing approach into their investments and advisory services.

However, due to prevailing widespread misunderstanding, many schemes, investment consultants and asset managers, including within the LGPS, remain cautious of pursuing an impact investing strategy. Alongside other influential thought-leaders, including the Principles for Responsible Investing (PRI), we have developed **proposals for how the concept of fiduciary duty, and the supporting regulation and guidance, can be clarified to make it easier for pension scheme trustees/administering authorities to consider the impact of their investments on society and the environment**. This could help to unlock capital to realise the 5% target of

LGPS to be invested in assets that drive local, sustainable economic growth. We would be happy to discuss this opportunity further with the APPG.

2.2 Supporting local authorities

Alongside unlocked LGPS capital, the engagement of local authorities is key to ensuring that any development of place-based impact investing by financial institutions is developed in a way that is not only viable but as beneficial as it can be to that specific local community. Currently, however, there are significant information and capability gaps in local authorities, including:

- the ability to measure and articulate the social or environmental value of a project;
- standard or template business cases so that project owners within local authorities do not have to start from scratch for every project;
- appropriate governance processes for innovative projects;
- understanding of the desired risk, return, liquidity, scale or term of an investment for different investor types as well as how decisions at financial institutions are made;
- contacts within financial institutions or investors; and
- development of co-investment models, which can go some way to addressing any political uncertainty (frequently a risk that is hard to quantify for investors).

Local authorities also face significant weaknesses with regards to:

- capital – the balance of risk and return for particular investments may not be attractive enough to financial institutions, and public procurement rules make it hard for investors to navigate the landscape;
- capacity – while local government is run by many highly competent people, they often lack the time to look into attracting external investment; and
- skills – local authorities do not typically have an investment mindset and they lack financial expertise or the ability to judge investments.

In response to these challenges, we recommend that government provides local authorities with the capability support they need to engage with financial institutions with regards to information, capital, capacity and skills. In turn, we recommend local authorities focus on the following priorities:

- articulating clear development priorities and a vision for their local area, as well as developing ways of communicating these aims to financial institutions;
- committing resources to engaging with private sector partners, both on overarching strategy and detailed commercial negotiation, including provision of the information that financial institutions will need to rely on, to encourage the development of the types of local partnerships that are key to long-term place-based impact investing; and
- ensuring that local people are involved in each stage of the process when working with new financial partners.

We are piloting this approach in Wakefield, in partnership with Wakefield Council. In the first stage of the project, we are supporting the council to identify and review projects with the potential to attract private impact investment and building the capacity of the Wakefield senior team to interact and build partnerships with providers of private finance. The second stage will directly facilitate this engagement, inviting financial institutions to review and engage in dialogue with the council about investment opportunities. We are in the process selecting a second pilot location, with the aim of scaling up this approach across the UK. As part of this work, we are also partnering with Involve (a leading UK public participation charity) to develop a framework that will inform how investors can best engage with local communities when making investments.

2.3 Blended finance

Blended finance plays an important role in addressing risk/return barriers. Blended structures can provide investors with the opportunity to increase portfolio exposure into strategies which demonstrate strong fundamentals, but may have historically been associated with high perceived risk. While blended finance has been traditionally used to mobilise capital into emerging markets, there is increasing evidence of the usefulness of this approach for investments in the UK as a means of financing transition activities, including finance for green infrastructure and development of the labour market in response to the transition.

Blended finance instruments include subordinated capital, guarantees, tax reliefs and development grants that de-risk projects. One such example of subordinated capital, provided by the public sector or private impact investors to absorb any losses first, is the Bristol and Bath Regional Capital - City Fund. Bristol City Council and Big Society Capital each invested £5m, alongside a £1m grant from the Access Foundation, acting as a First Loss facility to be used to underwrite loss on a deal-by-deal basis. The Fund targets an Internal Rate of Return (IRR) of 4% and seeks to contribute towards shared efforts to reduce inequality and improve public spaces which were being delivered by civil society in Bristol. Example investments include pre-planning (high-risk) investment in a community group to invest onwards in a wind energy project, and Xero-e, a green business-2-business delivery service. More information is available here (p9-10).

Government can lead the way by supporting the further deployment of the many proven blended finance instruments and tools that can demonstrably help mobilise institutional capital at scale for the transition to a net-zero economy. These include supporting the roll-out of: (i) subordinated capital; (ii) guarantees; (iii) insurance; (iv) securitisation; (v) performance data; (vi) information and partnerships and, in the context of emerging markets, (vii) local currency financing.

Perhaps the most promising tools are the increased use of guarantees and insurance coverage at a portfolio and vehicle level, as they allow for unfunded risk mitigation. Government is encouraged to expand its use of these tools both domestically and in emerging markets, so that more institutional investors can participate and deploy capital for the transition. Incentivising quasi-state actors like British International Investments (BII) and the UK Infrastructure Bank (UKIB) appropriately to use and develop blended finance instruments should also be considered (see next paragraph).

Government can support market activity and innovation by putting private capital mobilisation at the core of the mandate, targets and remuneration structures of financial institutions accountable to it (including those of which it is a shareholder), such as BII, UKIB, the British Business Bank (BBB), and others. Government can also support by working to amend the objectives of these banks and agencies to make capital mobilisation an objective of equal weight as balance sheet investment and structuring incentive mechanisms so that every mobilised pound receives as much recognition as every pound invested on the organisation’s own account.