Investor Panel

Mobilising international capital to help finance the transition to Net Zero

Co-Chair's Foreword

It is clear that the cost of the transition to net zero is beyond the scope of traditional sources of funding. Investment at scale is going to be needed and the public and private sectors are going to need to work together to secure it. This has been recognised by many countries and competition for capital is likely to be fierce.

The Panel was formed to make recommendations as to how the Scottish Government can compete for mobile capital investment. At inception the then First Minister charged the Panel to be direct in our assessment of the issues and to deliver practical proposals which, if implemented, will make a difference.

Scotland can attract investment, but it suffers from its small scale relative to other countries, limited historical engagement with international investors and like the UK as a whole, has some barriers to achieving the investment we need to support our just transition to net zero.

The Investor Panel's proposals aim to allow the Scottish Government to exploit Scotland's intimacy and devolved powers to make it a globally competitive investment destination. We believe this can be achieved through clearly determining priorities, being more agile in decision making and adopting the proven practices of small states and countries that have successfully attracted investment at scale.

We believe if adopted these recommendations, in conjunction with a broad upskilling of public officials, will increase the pool of capital available for investment in Scotland, decrease its cost and expedite the critical investment necessary to make the just transition to net zero happen.

Angus Macpherson
Chief Executive Officer, Noble & Co

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Background

- The Investor Panel was formed in December 2022 to make recommendations as to how Scotland can attract mobile capital and investment to support Scottish Government policy and the just transition to net zero, particularly around the physical infrastructure required to support this transition
- Attracting mobile capital is important because the scale of investment required for the transition to net zero and for projects like ScotWind will require a fundamental shift from funding to financing and for the public and private sectors to work closely together
- The international capital markets are highly competitive. Scotland does not have the depth of market or financial resources of countries or regions such as the US, China, the Middle East or the EU. We must find suitable ways to allow Scotland to fulfil its potential
- The recommendations made by the Panel set out in this document relate to the way that the Scottish Government, its agencies and public sector partners engage with investors and how Scotland is perceived as an investment environment
- By way of example, some recommendations specific to attracting investment in ScotWind, Hydrogen and heat in buildings are also included which have been identified as areas of focus

The Panel comprises:

• Angus Macpherson (Co-Chair)	Chief Executive, Noble & Co
• Alexandra Basirov	Head of EMEA ESG Finance & Solutions, Bank of America
• Shane Corstorphine	Ex-Skyscanner CFO & scale up consultant
• Judith Cruickshank	Managing Director, Commercial Mid Market Banking, RBS
• Baroness Margaret Ford	Chair, Gatwick Airport
• Michael McGhee/John Watson*	Global Infrastructure Partners
• Andrew Telfer	Senior Partner, Baillie Gifford
• Gavin Templeton	Managing Director, Pollination

*Alternate

Peter Reekie, Chief Executive of Scottish Futures Trust and Willie Watt, Chairman of the Scottish National Investment Bank acted as advisers to the Panel

Methodology

- We looked at the current environment within which infrastructure decisions are made and whether the overall landscape could be improved to better attract mobile capital
- We also held confidential conversations with over 40 institutions, companies, advisers and individuals who are active in making infrastructure investments and, mostly, know Scotland
- Our objective was to identify practices that have proved effective in other jurisdictions which could be adopted in Scotland
- To build on our own experience and expertise we looked at two different jurisdictions which are widely regarded as doing this well, to see what lessons there might be for Scotland. These were Western Australia and the Republic of Ireland. Feedback was also received on practices followed in Portugal, Canada, Singapore and Norway
- Conversations also took place with officials of the Scottish Government, Scottish Enterprise, Highlands and Islands Enterprise, South of Scotland Enterprise, Scottish Futures Trust and the Scottish National Investment Bank
- Support for the Panel was also provided by the Universities of Edinburgh and Strathclyde

Underlying premise

- Our underlying premise is that Scotland could be better at attracting mobile capital. It is clear that the scale of the Scottish Government's ambition to transition to net zero will require financial investment that is far greater than anything that has been accomplished to date
- Providers of infrastructure capital are conservative, have long term horizons and a defined risk appetite. Consequently, they are ideal partners for long-term, stable projects which operate at scale
- Scale matters, for reasons of return and costs of transaction
- There is limited appetite among major investors for sub-scale, overly complex or piecemeal transactions
- While seen as an investible market with similar risk characteristics to the rest of the UK and Europe, Scotland suffers from its size relative to competing investment destinations. By way of illustration, its population is less than any of the largest fifteen cities in China. Consequently, it is harder for it to attract attention and there are fewer opportunities of scale
- However, the Panel believes that Scotland's intimacy and devolved powers could allow it to differentiate itself positively from other markets by being proactively 'investor-friendly'. This could be achieved by being more agile in decision making and adopting proven practices of small states which have attracted investment at scale
- If achieved, this should increase the pool of capital available for investment in Scotland and decrease its cost. As the competition for capital becomes even more intense globally as other countries seek finance for their own transition, this would be an important national advantage

Characteristics of investor friendly destinations

Investors tell us that attractive investment destinations have some common characteristics:

- The political atmosphere and posture is positive and encouraging towards private investment with knowledgeable and credible senior politicians and officials who invest time at the right level and in the right relationships
- There are clearly-articulated, credible, long-term policies encompassing net zero targets and sector priorities
- Policies favour a national approach to scale investments
- Physical planning of critical infrastructure is prioritised and fast tracked
- Government makes difficult decisions between competing policy objectives quickly and clearly
- Government and public sector leadership is energetic, focussed, decisive and aligned
- Investor relationship management is taken seriously and is regarded as a long-term exercise which requires a professional approach
- It is clear to investors who they need to engage with and how
- Infrastructure priorities that require government intervention are planned, shaped and costed: these form a pipeline, not a wish list
- Government is sensitive to decisions which impact the risk, reward or timing of investments and any negative impact is communicated and where possible mitigated

Challenges to investing in Scotland

Scotland can be a challenging investment destination

Investors tell us that doing business in Scotland, relative to many other places, poses some significant challenges:

- There are few visible opportunities for scale investment and where there are major projects they can be limited in breadth offering little opportunity for diversification of risk
- Planning decisions are slow and sit in the system for unacceptably long periods both generally in the United Kingdom and in Scotland specifically. Such delays and uncertainty involve additional risk and cost to investors
- The prevailing perception is that the Scottish Government and wider public sector is not supportive of business
- It is not apparent that the Scottish Government considers the impact of its actions on investment appetite from the outset
- It is not always clear to investors that the Scottish Government fully understands that they need to make a competitive return on their investment consistent with the risks
- Policy and regulation that seriously affects investment decisions and returns sometimes gets changed at short notice or with very little effective engagement
- There is significant potential to increase the consistency of skills and understanding within the Scottish Government and its agencies of private sector investment requirements to better inform upstream policy development and downstream policy implementation
- The Scottish Government has a plethora of objectives; it needs to determine its priorities and communicate them clearly through an investment lens.
- There is no clear, costed pipeline of opportunities similar to, for example, Western Australia
- Compared to other places such as Ireland, there is no coordinated mechanism for managing consistent, meaningful relationships between the Scottish Government, the public sector and existing and potential investors. Given the choice, there are other places investors will prioritise for their investment

Areas of recommendation

The transition to net zero, globally and domestically, requires massive public and private investment. Scotland's competitive advantages and ambitious policy commitments require a new and very different approach from that currently taken by the Government and its agencies if Scotland is to attract the scale of global capital needed to finance this activity.

As part of this exercise we have reviewed the practices of small countries and states which investors tell us are attractive to invest in. We set out a range of recommendations based on these, and other, observations which we believe should be considered.

The wider political case needs to be made to create an acceptance that, to get to net zero and realise associated economic opportunities, external finance is essential and that the providers of this finance require a competitive reward for the risks that they are taking.

The political atmosphere needs to develop into a mature, mutually-respectful relationship with providers of finance.

To do this, the Scottish Government needs to define and then communicate its core priorities, increase its engagement with, and knowledge and understanding of, investors and develop more tightly-defined delivery plans for those priorities.

Our objective has been to make broad recommendations, which if accepted, will allow the Scottish Government flexibility and scope around implementation. They are grouped in three themes: strategic direction, investor engagement and delivery.

Recommendations

Recommendations: strategic direction

1. The current public sector landscape around attracting mobile capital needs to be simplified and given clear focus
2. The Scottish Government should review the balance between its narrowly focussed regulatory roles and processes, as well as those of its agencies and local government, against the need to attract investment at scale to achieve the wider strategic goal of achieving net zero
3. National and local government need to be disciplined and clear about their role in infrastructure projects; for example whether this is as a funder, a co-investor, or a planning authority
4. Net zero and sector priorities need to be clearly articulated in Government strategies in a way which shows they can be delivered
5. The concept of subsidiarity needs to be reviewed in the context of delivering infrastructure critical to the transition to net zero. Where projects can be designed or delivered nationally at scale, this should be the default option
6. The Scottish Government's interaction with regulators, including those at the UK level, should be strengthened to expedite the delivery of major infrastructure projects

Recommendations: investor engagement

7. The most appropriate providers of finance and expertise need to be identified and segmented. A serious, professional and consistent relationship management approach needs to be taken to these institutions
8. Although it will involve additional costs, Scotland's profile could be significantly raised in the international capital markets by using existing devolved powers to issue debt. This will provide a motivation for regular engagement by investors and an opportunity to market Scotland's investment story. It would also allow the development of relationships with providers of debt, a track record and credit rating
9. The current investment pipeline is too diffuse. A pipeline needs to be formed of projects that are properly costed, shaped and prioritised. It needs to be a real pipeline, not a wish list
10. Once relationships have been established, an annual meeting should be held to engage with these investors around the opportunities in this pipeline. Feedback from this event should result in regular refinement of the pipeline
11. ScotWind has the scale to attract global investor interest. A state sponsored conference, at the right time, should be considered to attract key international investors to Scotland. This would also serve to raise the profile of the broader investment landscape
12. Investors and market participants are concerned that the Scottish Government and the Crown Estate Scotland may find it difficult to secure all of the published commitments from developers and a continued focus will be required to ensure commitments are realised

Recommendations: delivery

13. The revised Scottish Government's investment objectives and associated pipeline should dictate the amount, type and focus of resources
14. An exercise needs to be undertaken to fully understand the financial and human resource currently committed across the Scottish Government and its agencies to attracting mobile capital and delivering core investment priorities
15. The roles and responsibilities of organisations and teams should be reviewed and made clear and an assessment of their capacity and expertise to unlock investment undertaken. Changes are likely to be required to meet the scale of the delivery challenge
16. A mechanism needs to be put in place whereby the implications for investors and investor sentiment are taken into consideration when policy is formulated or legislation developed across all of Scottish Government. This also needs to apply to how policy is delivered
17. The implementation of the policy within the National Planning Framework 4 of a requirement for planning authorities to give significant weight to the global climate emergency when considering development proposals should be monitored to see if it results in a faster, more certain planning process for development projects such as those associated with ScotWind
18. Building on the recommendations of the UK Electricity Networks Commissioner Report, the Scottish Government should make representations to the UK Government on the development of a master plan for the implementation of the grid expansion necessary to meet the needs of ScotWind
19. A plan needs to be developed for the scaling up of a floating offshore wind pilot scheme to assist in developing other sites at scale. This can leverage learning from the innovation projects emerging from the existing INTOG (Innovation and Targeted Oil & Gas) leasing round to start a practical conversation on the floating offshore wind supply chain opportunity for Scotland
20. The Scottish Government should evaluate the economic viability of pipeline exports of green hydrogen, generated by ScotWind projects, to Europe, relative to green hydrogen created in the Mediterranean rim
21. Public financial resources and policy should focus on the use of green hydrogen as an enabler for industrial decarbonisation
22. Public sector connection to heat grids should be mandatory to provide the right demand signal for private investment into heat sources. Extending this regulation to new commercial real estate and large-scale housing development should be accelerated

23. Private investment into heat sources can be accelerated by creating a viable margin for district heating. This can be facilitated by reducing upfront costs, such as planning, and focusing subsidies on the market for renewable heat
24. For institutional investment at scale to be attracted to the residential housing sector to help finance its transition to net zero, greater clarity as to the stability and quantum of returns is required
25. The Scottish Government should consider the recommendations of the Offshore Wind Champion and implement those that are within its devolved powers, including ensuring there is adequate resource for the Marine Directorate of Scottish Government and NatureScot to meet responsibilities in ScotWind
26. The Scottish Government should improve engagement between the newly established Offshore Wind Directorate and the industry to ensure a focus on maximising opportunities around offshore wind operations and maintenance
27. The Scottish National Investment Bank should be able to provide guarantees and underwriting at scale in line with the capabilities of many other investment or development banks
28. The Scottish National Investment Bank should invest pre-emptively in the supply chain for ScotWind, complementing the tax incentives offered by the Green Free Ports
29. Public leadership needs to continue to upskill to be able to act as effective counterparties to major investors and must commit to continually deepening this knowledge and understanding. These skills need to be learned from those with proven expertise and who embody international best practice
30. Attracting mobile capital is a specialist area and the Scottish Government does not have the resources to build every capability to an adequate standard itself. Using external commercial specialists might prove to be a better value proposition
31. A culture needs to develop that is rigorously focused on outputs, not inputs or on process management

Sectors the Panel focused on

Most of our recommendations apply to all investments, however some are specific to priority sectors identified in discussion between the Scottish Government and the Investor Panel – ScotWind, Hydrogen and Heat in Buildings.

ScotWind is a globally-significant offshore wind opportunity offering development rights for 20 projects with an associated £70 billion of expenditure[1]. It faces challenges. There is strong global competition for resources and investment. Changed market conditions resulted in no bids being submitted for offshore wind in the most recent UK Contract for Difference (CfD) auction, however the UK Government recently announced they have raised the maximum price offshore wind and other renewables projects can receive in the next CfD auction. However, the scale of lease option awards exceeds the currently anticipated grid capacity.

Unlike oil and gas activity, which has an extensive services sector and generates significant tax revenue, the main direct economic benefits to Scotland from offshore wind are most evidently the rental payments to Crown Estate Scotland, developing a supply chain, and providing Operation and Maintenance (O&M) services. The Scottish Government should therefore focus on these areas.

Continued uncertainty on grid connection and CFD, both reserved issues, impose commercial risks which act as an impediment to projects investing in the supply chain and supporting infrastructure.

Scotland has a potential comparative advantage in securing a meaningful part of the supply chain for floating wind. However, this is a new technology, and the commercial rollout of floating offshore wind will take time to scale and significant preliminary infrastructure costs will be incurred.

Green Hydrogen has captured considerable attention, but it is still a developing industry and it is clear that more work is needed to consider the extent to which it will be economic to produce for export, at scale in Scotland.

The capital cost of converting the Scottish building stock to zero emissions by 2045 is in the region of £33 billion[2]. The Green Heat Finance Taskforce has recently published its Part 1 report with recommendations on how to address this gap.

[1] Based on estimates in Supply Chain Development Statements, https://www.crownestatescotland.com/scotlands-property/offshore-wind/scotwind-leasing-round

[2] Scottish Government, Heat in Buildings Strategy, https://www.gov.scot/publications/heat-buildings-strategy-achieving-net-zero-emissions-scotlands-buildings/

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