Draft Climate Finance report

Summary

This report sets out to look at two matters: firstly, how to generate more of the investment required to deliver Southwark's climate emergency strategy and action plan and, secondly, to analyse the progress made on decarbonising Southwark Council's Pension Fund. It also explores potential synergies between these two objectives.

Investment required to deliver on the climate strategy

As part of developing Southwark's climate emergency strategy and action plan, the Council commissioned experts from Carbon Descent and Anthesis to carry out work to assess the scale of the challenge and the cost of meeting our ambition. This work demonstrates that as well as investing our own resources, Southwark will require considerable additional investment and will need to find ways to leverage funding into the borough to support not just the council, but other stakeholders including businesses, educational and cultural establishments and residents too in their efforts to decarbonise. The scale of the challenge is huge. Experts estimate that the cost will be around £3.92bn in capital expenditure, supported by additional revenue funding.

Sources of funding

Officers have identified that potential investment or funding streams include, but are not limited to, the Council's own carbon offset fund (the Green Building Fund), HRA funding, central government grants, revenue and capital funding from the GLA or TfL and various funding bids across the public, private and charity sectors. The Council has a demonstrable track record here with significant sums already raised through the Public Sector Decarbonisation Scheme (PSDS) to retrofit council buildings, large grant awards to take forward heat pumps and networks, as well as a range of other bids, often in partnership with other stakeholders.

The Committee on Climate Change has estimated that reaching zero carbon by 2050 will cost the UK £1.4 trillion, about a third of which is expected to come from the public sector. Therefore, about two thirds of is expected from private capital.

This report considers, in particular, some potential sources of private investment capital, which are currently underdeveloped in Southwark. A start has been made here with the Southwark Green Finance. Additionally there are some large government backed initiatives which have recently been launched and Southwark Council could partner with these to make the most of the private finance available. Of particular interest are a partnership programme recently launched by the Green Finance Institute

(GFI) and the work of 3ci. Both bring together investment and public sector expertise, and take a place based approach.

A place based approach to mobilising public and private investment

The focus on a place based approach is significant. The UK Government's Net Zero Strategy highlighted that 82% of all UK GHG emissions are within the scope of influence of local authorities. A study, cited by GFI, and conducted by UKRI, involving six diverse local authorities, showed that taking a place-specific approach would require £58 billion total investment between now and 2035 and would return a total of £825 billion in social and economic benefits in the next 30 years; whereas, a place-agnostic approach would require a total of £195 billion investment and return £444 billion in the same timeframe.

The Green Finance Institute is championing this approach. The GFI was established by government in 2019. It is led by bankers and commercially focused, bringing together experts and practitioners to mobilise public and private investment to deliver clean growth. In July 2022 GFI launched a Place Based Partnership, whereby GFI will partner with local authorities to bring forward local Climate Municipal bonds, as well as promote uptake of green mortgages, and deliver innovative finance models to enable homes owners to access capital to retrofit their homes. Retrofit of private homes, by both owner occupiers and landlords, will be crucial but increasingly challenging as it will take a sizeable investment to both insulate and then install renewable energy systems.

Local Climate Municipal Bonds utilise the savings of local people to both provide capital for investment and generate community buy in. Several councils have now issued Climate Bonds, delivered by Abundance, who work with GFI. These generate a return on investment for local people whilst providing capital for a range of green initiatives from solar arrays to electrified buses. A small proportion of investors – estimated at roughly 8% by Abundance – donate the interest earned on their investment, enabling projects with no revenue stream to be paid for, such as tree planting.

These funds are projected by GFI to have a small but important role to play, complimenting funds available through the Public Works Loan Board (PWLB). GFI see Climate Bonds providing 5% of lending to councils by 2030. The local capacity here is huge: for every 100,000 people there is 4 Billion available in savings. With the right engagement research finds, 70% of people would be willing to invest in Municipal Bonds.

3Ci is a partnership between Connected Places Catapult, CoreCities UK, London Councils and the wider local government sector aimed at supporting local authorities in their quest to secure the necessary long-term finance for achieving Net Zero. 3ci also takes a place based approach and provides a model and expertise to deliver a pipeline of projects. The starting point is to identify which parts of local authorities' climate strategy are revenue generating, and how councils can work with partners with different types of expertise and assets to bring forward projects. Examples include renewable energy generation, which is likely to provide an income stream. These revenue generating projects can then potentially cross fund projects which are harder to finance, such as decarbonising waste.

Carbon Offsets, in the council and beyond

Another source of funds is Carbon Offset. The council has established the Green Buildings Fund, using the carbon offset funds paid by developers. This will be open to community bids this year. There is potential synergy here with plans in development by London Bridge Business Improvement District (BID). London Bridge BID is keen to develop a model whereby businesses located in the area offset their carbon emissions by investing in the local community. Possible schemes include solar and retrofit projects on schools and council housing, as well as tree planting. With its community links and existing governance arrangements, the Council is well placed to be a partner in this initiative and to deliver assurance and transparency with regard to the local environmental and community benefit of any given project. London Bridge BID also has corporate partners who can offer such assurance.

Southwark acting as system leader bringing forward a green pipeline of projects using a mix of finance

This report considers how we could facilitate the better use of private investment and mixed funding for projects in the pipeline. This is across the scale from individuals investing in retrofitting their homes, through to local rewilding initiatives and up to larger scale projects, such as District Heating Networks. Many of these could be delivered through a mix of public and private funding, depending on their ability to generate revenue or savings and/or attract donations.

Research by Leeds University has scoped out the range of society finance[1] for social and environmental outcomes. The UK is advanced here. Options include debt from Public Works Loan Board , crowdfunded donations, crowd debt, Climate Municipal Bonds, community equity shares (the Community Energy model) , institutional private investment, public grants, carbon offset funds, as well as existing capital and revenue streams.

The council's partnership with Veolia to combine grant funding and private capital to deliver the expansion of the District Heating Network, which generates revenue through sale of energy, is an example of just such a project that the Council is already in the advanced stages of delivering. Another example, outside of the council, is the work of community energy companies such as SE24. These bring forward projects, by utilising Community Benefit Companies social entrepreneurial skills, through negotiation with asset owners (e.g. schools and community centres) relying on a mix of share equity from residents and grants. The outcomes are a reduction in carbon and fuel costs for the asset owner as well as social outcomes such as locally targeted fuel poverty relief and greater community awareness and buy in for energy transition. A partnership with 3ci would develop this capability, in the Council and community, and apply it to other sectors. Examples could include utilising the buildings of local partners to generate the power for commercial EV charging points, or developing

[1] FINANCING FOR SOCIETY Assessing the Suitability of Crowdfunding for the Public Sector, LOCAL AUTHORITY GUIDE, University of Leeds, May 2019

green infrastructure and improving local habitats for wildlife by landowners collaborating, or creating local circular waste systems through combining the work of BIDs, carbon offsets and a partnership with Veolia.

This would see the Council playing a role as system leader, using its convening, enabling and brokering capacity to bring together different groups: local businesses and asset owners, residents, investors, and local BIDs. As such, 3Ci says this demands a different mind-set, akin to the ambition of the climate strategy where the Zero Carbon by 2030 was for the whole Borough of Southwark, not just what the council has responsibility for delivering directly. The ambition the Council has shown here for the whole borough is already mobilising other parts of the community to align with Southwark's plan, with the London Bridge BID adopting the same target. This is in line with the role 3ci envisages the Council would play in facilitating a whole borough plan to decarbonise Southwark. An expansion of this ambition would pave the way for the Council to work with all parts of Southwark collaboratively to develop an economic ecosystem capable of delivering net zero by 2030, utilising the considerable local resources available.

3ci recommend that the Council consider additional capabilities that it would require to do this and highlight that having sufficient project development capacity and the capability to work with partners (schools, community and cultural institutions, Business Improvement Districts, SMEs) to develop a portfolio of projects is a key competence. As such it is recommended the Council employ a project director with a commercial background in social enterprise (or similar) to bring forward a green pipeline, and envisages this role would pay for itself, as well as contribute to community wealth building.

Southwark Pension Fund

In December 2016, the council committed to divest Southwark Pension Fund from fossil fuels, and more recently pledged that the fund would be carbon Net Zero by 2030. Southwark's commitment to divest makes the local authority an early adopter, with our fund already 55% decarbonised. The Pension Fund's front running work on divestment has been challenging as there is a lack of financial products and set standards on Environmental, Social and Governance (ESG) investment criteria. Government regulation on carbon intensity is now in development, with GFI leading on this. There are also initiatives and wider coalitions working on this agenda that could support our work.

The Pension Fund has already taken most of the easier steps to decarbonise, including ending direct investments in fossil fuels, moving money into renewables as well as adopting innovative approaches to reduce its carbon footprint, such as retrofitting its property portfolio.

This report looks at what more can be done to decarbonise the rest of the portfolio. This includes taking account of global markets with significant investments in fossil fuels and the opportunities to move money into renewables, such as solar and wind, as the transition accelerates. It also recommends that investment decisions consider the wider economy, as industry powered by renewables takes over from fossil fuel dependent industries. Examples are Electric Vehicles (EVs) replacing petrol and diesel powered cars and predictions that eventually EVs will take over the fossil fuel powered freight industry. Other examples are changes to the energy distribution network, including the scaling up of battery technology, and the move away from plastics and towards biodegradable alternatives. Moving investments to the right places at the right time has the potential to both accelerate change in the wider economy and make the most of opportunities to generate wealth, as well as mitigate the risk of losses to the fund through investment in stranded assets. This has the co-benefit of producing a more socially equitable economy as both energy security (i.e. through diversification away from fossil fuels) and wealth are distributed more widely, rather than being concentrated in a few oil rich countries. These changes to the Pension Fund portfolio can be delivered primarily through changes to equity investments, both active and passive index linked funds, and corporate bonds, as well as continuing to make the most of huge opportunities to invest in green tech. This is in line with Southwark Pension Fund's current investment strategy.

Pension funds are very large sources of capital that are increasingly invested in the global market. However this was not always the case – post war most investment was in UK industries. In other countries Pension Funds do invest in local infrastructure such District Heating Networks. The recent move to re-localise the economy through community wealth building, in recognition of the social, environmental and economic benefits of a local economy, is a worthy goal that could be supported by pension funds. A possible avenue is the London CIV, which pools the city's pension funds. This would potentially have the governance capacity to build a local green infrastructure fund.

The Pension Fund could also consider investing in Municipal Climate Bonds as these are a recognised form of green gilts. Currently our index linked gilts are a high carbon part of the portfolio, although they do protect against inflation.

The report also considers how more could be made of our achievements to date, in order both to celebrate our success and acknowledge the seriousness of the task. This should promote a further shift in the market and also to encourage the wider divestment movement, given that one purpose of divestment is to delegitimise fossil fuels.

Contributors: to be completed

Themes: in development

- A place based approach mobilising public and private investment
- Municipal Bonds
- Carbon offset
- Green projects pipeline
- Southwark Pension Fund

Summary of Recommendations

<u>Recommendation one</u>

Partner with the Green Finance Institute to bring forward the following programmes:

- **i) Integrated Retrofit Finance: Incorporating attractive private financial options into retrofit programmes in the community.**
- **ii) Green Mortgage Campaign: Collaborating with local and national mortgage lenders, brokers and influencers, the GFIs campaign aims to increase awareness and engagement across the market.**
- **iii) Local Climate Bonds (LCBs): A debt instrument issued by Local Authorities to raise to raise capital to fund their net-zero and low-carbon projects.**
- **iv) Green Rental Agreements (GRAs): Innovative form of rental agreement to address the 'split incentive' between landlords and tenants in privately rented homes.**
- **v) Property Linked Finance (PLF): A new, innovative financial instrument that enables homeowners to receive financing to support 100% of the upfront costs for a retrofit project.**

<u>Recommendation two</u>

Partner with Abundance to bring forward a Municipal Climate Bond in recognition of their role in generating increased economic, social, and environmental capital.

<u>Recommendation three</u>

Build on the research Leeds University report on Financing for Society, and partner with 3ci to build a green projects pipeline. This will identify potential climate projects, both inside the council and with partners that can be delivered utilising the most appropriate sources of finance, from investment institutions, PWLB, Municipal Climate Bonds, issuing community shares, and donated crowdfunding etc.

<u>Recommendation four</u>

The Council employ a project director with a commercial background in social enterprise to bring forward a green project pipeline, with the expectation that this role would pay for itself.

<u>Recommendation five</u>

Partner with the London BID to support their carbon offset initiative

Recommendation six

Join collations and initiatives working on decarbonising Pension Funds including Climate Action 100 and the Science Based Target action plan

Recommendation seven

The Pension Fund updated investment mandate for corporate bonds includes Carbon Tracker's S curve to move out of dirty industries and into clean tech ahead of the curve, in order to prevent investment in stranded assets, and make the most of investment opportunities in green industries.

Recommendation eight

The Pension Funds existing plans to move Equity (active and passive) to low carbon funds also take account of a) global markets that are high carbon b) of risks and opportunities that exist in fossil fuel dependent industries as they shift to renewables.

Recommendation nine

Southwark Pension Fund collaborates with other London local authorities on the divestment journey to bring forward a London CIV sustainable green infrastructure fund to increase community wealth building and make the most of London and UK investment opportunities, such as, District Hearting Network, renewable energy generation and retrofit.

Recommendation ten

Celebrate the success of Southwark Pension Fund divestment to date and ensure the message is one a commitment to take a collaborative approach to divest away from dirty energy and into the growing clean, green, and more social equitable economy, in line with our declaration of a Climate Emergency.