GEOCAPITA

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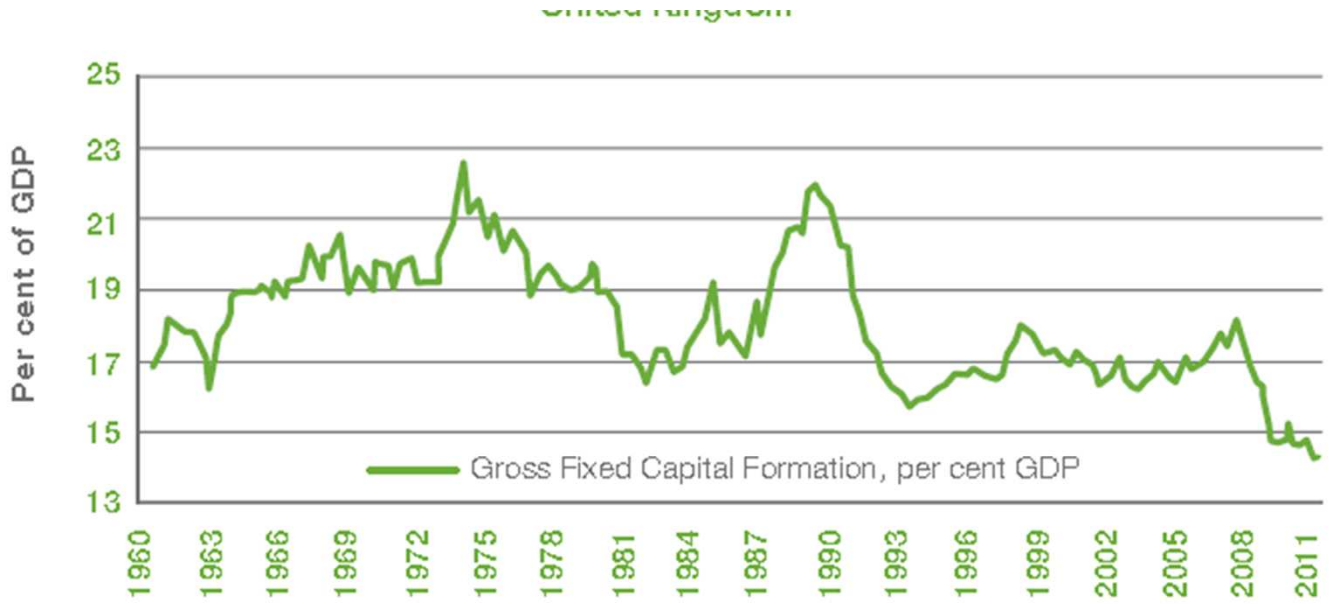
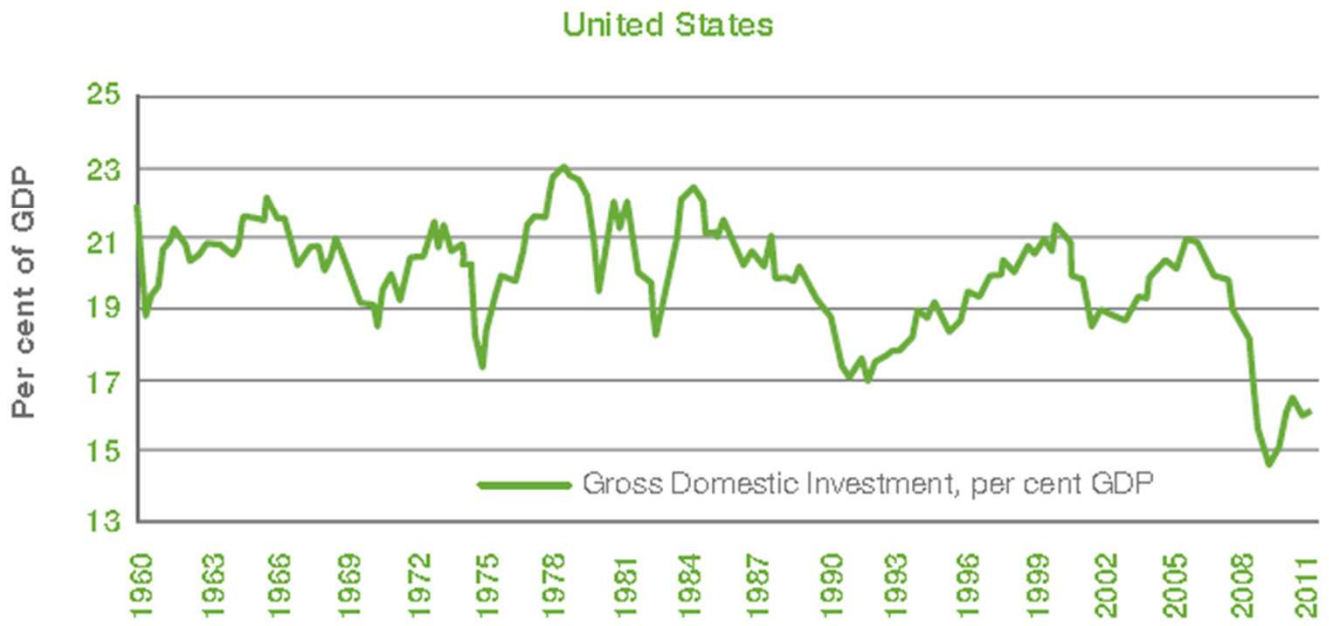
Macroeconomic situation

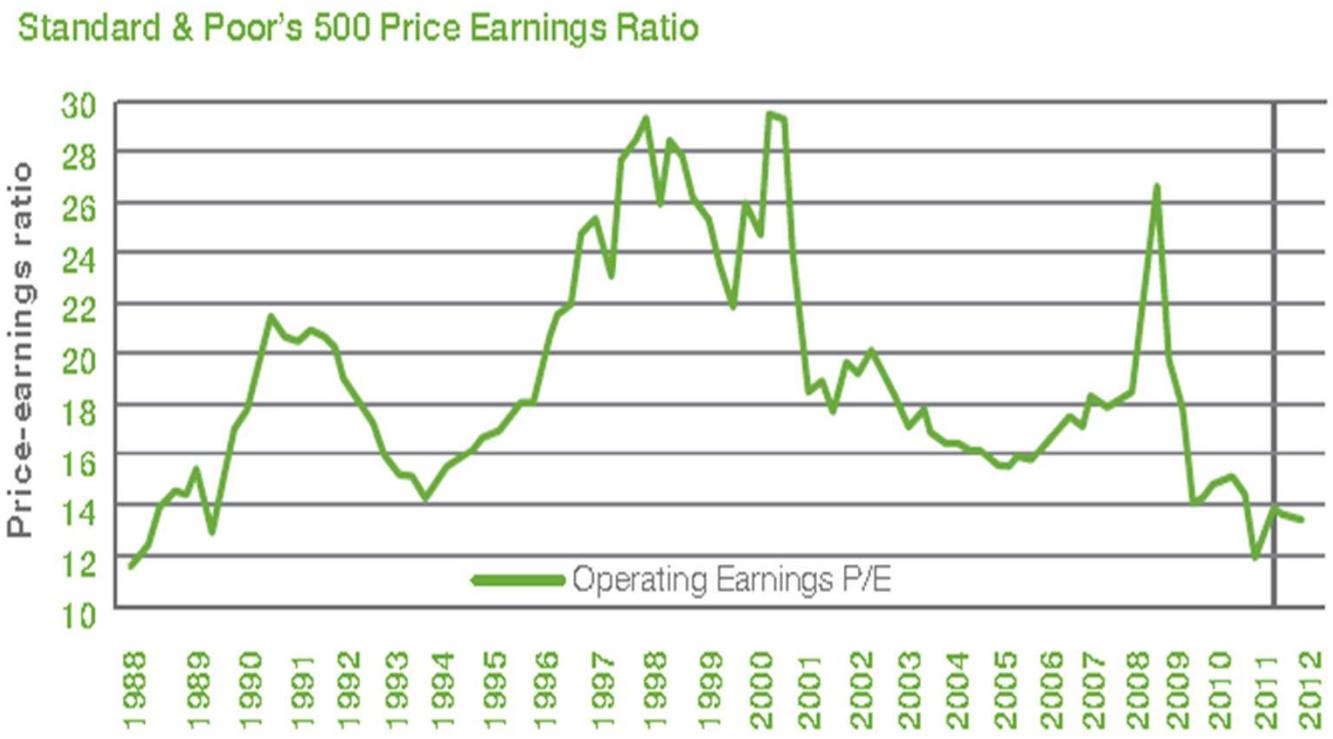
- QE - unconventional in size but conventional open-market operations.
- problem today: the secured market has become disconnected from the unsecured market. Thus, no matter how much liquidity CBs provide, they can't seem to encourage banks to create loans — at least those directly financed with monetary liabilities such as cheque and savings deposits.
- "Shadow banks" & "non-banks" were responsible for a lot more lending in the system than previously thought - banks were sourcing a lot more of their liquidity (for lending activity) from shadow banks than from pure customer deposits.
- when shadow banks took fright at the deteriorating quality of the collateral and demanded better collateral instead, this resulted in a massive rush for 'safe' securities, a process which simultaneously created a large funding shortfall at banks because large amounts of assets had become unfundable.

- When the bubble finally burst, overleveraged positions were exposed, asset prices fell and ballooning private debt was transferred to the public sector (‘privatize the profits/nationalize the losses’)
- Result, where are we? “a chronic condition of subnormal activity for a considerable period without any marked tendency either towards recovery or towards complete collapse.” Keynes definition (1930) of a Depression
- Austerity: ‘the time for austerity is in the boom not in the bust’ (Keynes)
- In recession/depression ‘the debtors can’t spend and the creditors won’t spend’ (Krugman)





Source: Bureau of Economic Analysis/Office of National Statistics, quarterly data to fourth quarter of 2011



Source: Standard & Poor's. Data of spot prices taken at the end of every month

Capital needed!

- UK Treasury has identified £137bn of projects.
- However bank debt margins have moved from 1% pre crisis to 3% now. Long term lending is not available. Banks have moved from 27 year to now typically 12 - 15 year loan maturities. For smaller ('riskier') projects 7 years is more common.
- QE hasn't helped - the money is stuck in the banks as they try to rebuild their balance sheets.
- All but one of the Monoline insurers has failed, so not possible presently to enhance bond debt from BBB to AAA.
- With the Solvency II Directive scheduled to come into effect on 1 January 2014, investors will have an increased appetite for A rated debt as opposed to BBB.
- Therefore a global solution is required.

Options being considered?

- Finance options – unchanged. Bank debt suitable for <£100m projects but with shorter maturities say 15 years (average loan life 12 years) with recognition that 30 years was too long and no one could have such a long term view of project viability. (Projects borrowed for 30 years because they could!)

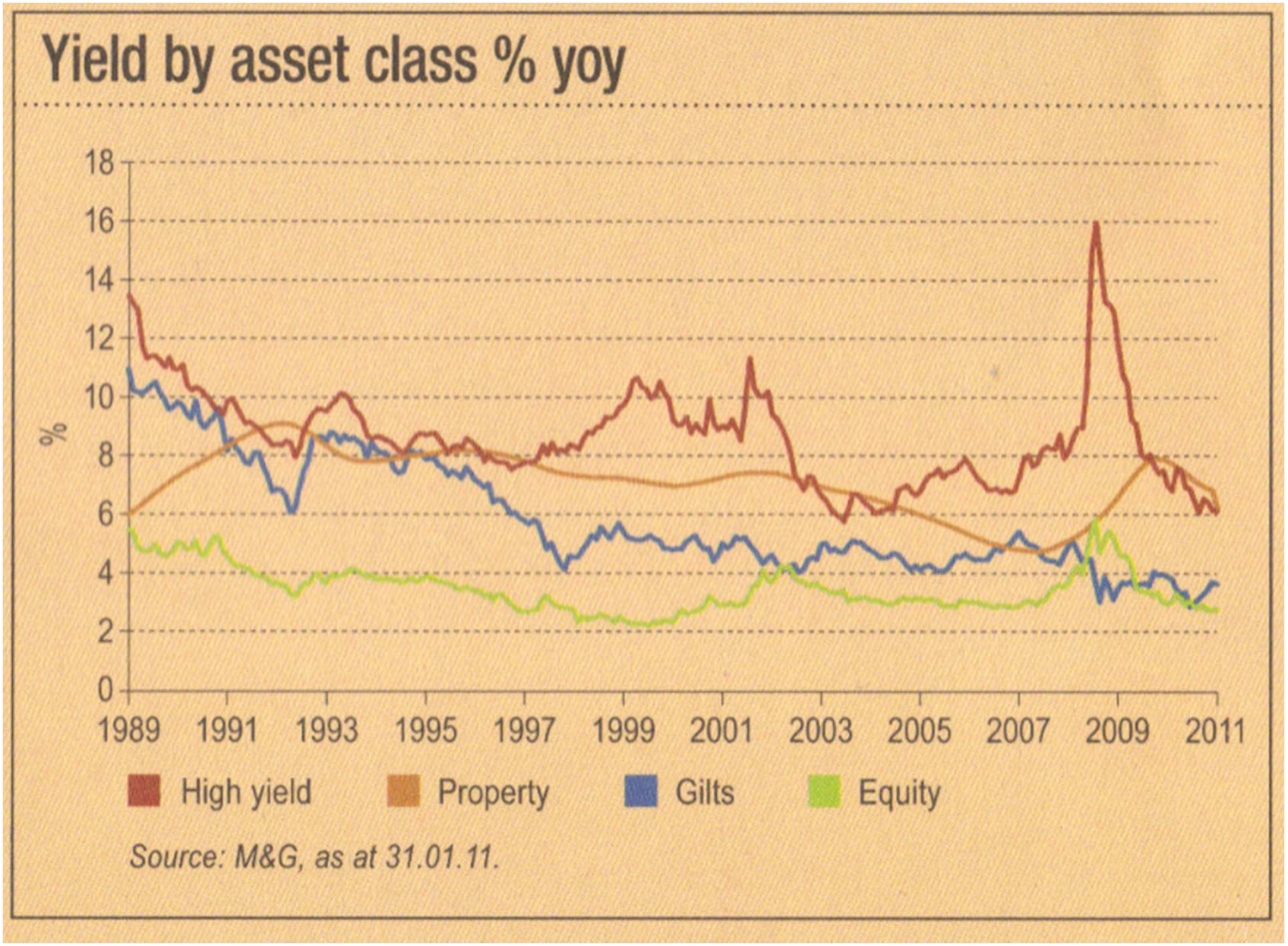
- Another option is 5 year bank debt refinanced in the bond market. Moody's have researched this and note that operational project loss is a small risk – default rate is 0.3% – helps to move projects to A-. However the issues are:
  - Risk of not being able to refinance
  - Pricing
  - Credit risk – if project goes bad – who takes this risk.

- Consideration being given to enhancing structures to improve project investment rating (untested as yet):
  - enhance LADs
  - lower the gearing (but equity is more demanding)
  - Govt offers a step in type of mezz tranche as this will help to get to A rating

- There is a large funding requirement developing –and the govt expects private investors to step up.
- many smaller community and SME Housing & RE projects.
- The PFI model has had bad press in the UK.
- Eventually smaller deals will be bank funded and larger deals with bonds.
- Need to move now however, not when the market recovers as this is in the indefinite - and quite possibly lengthy - future.

- Consultation going on with UK government (via PWC and others):
  - Can govt offer some ‘insurance’ style support?
  - improve hand-back provisions?
  - deal with cost effect of shorter maturity debt?

- Different market failures point to different policy instruments, so long as the collection of policies is mutually reinforcing
- economies cannot afford *not* to pay short-term investment costs
- A credible carbon policy must provide a degree of security that commitments will be met. Yet policy must be set in the face of known uncertainty



SOURCE: FT Financial Adviser 10 May 2012

New Sustainable PPP Model - PPC

- Global Green New Deal (UNEP 2008)
- UNEP Finance Initiative
- Sustainable ('green/ethical') infrastructure:

  Energy, economics, environment, equity (social and intergenerational)

- Public Private and Community:

  Community/SME RE

  Green Deal retrofit

  Affordable low carbon energy efficient new housing

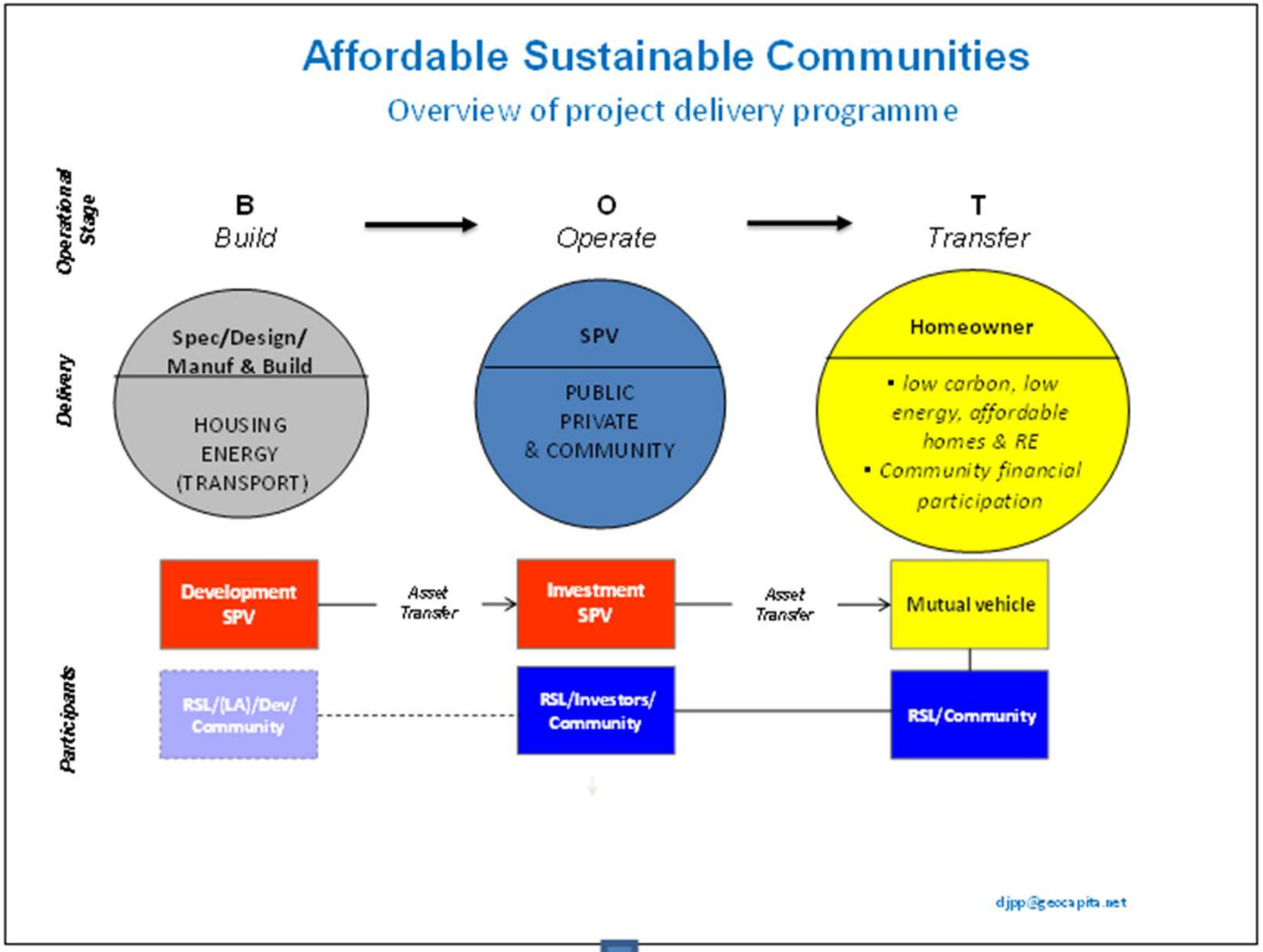
- Sustainable Communities:

  energy

  emissions

  fuel poverty

  local economic regeneration



New & retrofit housing — Fuel Poverty, Energy Security

Community RE — Emissions, Local regeneration, Improved returns

Sustainable Transport — Job creation/protection

Funding sources

- Green deal(s) provide scale and long-term credibility.
- Green policies do not require significant public spending.
- Credibility requires some public ‘skin in the game’
- Government borrowing (at very low rates) to underwrite credibility and foster large sums of private investment and innovation can help to restore growth.
- by contributing to growth, it will help reduce deficit and debt ratios.

List of some Green policies to address market failure

- pricing GHG emissions to reflect the damage they do and incentivise behaviour change
- correcting the GHG externality via carbon taxes, cap-and-trade and regulation.
- encouraging R&D where knowledge is a free good and 'spill overs' are large.
- supporting deployment of low-carbon technologies (FIT, RHI, Green Deal).
- supporting induced innovation of new technologies through cost transition.
- overcoming network externalities where the value of joining a network depends on how many others are in it (eg. electricity grids, public transport,) & which require government incentives to kick-start the network.
- addressing imperfections & market failures in risk/capital markets through risk-sharing and risk reduction that result in a lack of funding for projects of long term value.
- introducing labelling/information requirements on cars, domestic appliances & products to improve consumer awareness of substitution options.
- countering information asymmetries and so-called 'agency problems' (eg where a tenant & landlord possess different incentives to improve energy efficiency and so fail to act in their mutual interests).
- implementing competition policy, to encourage regulated utilities to be innovative (eg UK EMR with CFDs).

Source: A strategy for restoring confidence & economic growth through green investment and innovation, Grantham Institute and Centre for Climate Change Economics and Policies

Sample housing projects in UK

- Owenstown eco-village
- Energize Barnet
- Warm Wales eco-housing
- Inveresk Care Village