With demand for loans from English councils likely to rise sharply, will Salix Finance have the resources to bridge the public sector gap?

Six months on from our last review of Salix, we assess whether the latest round of DEFRA funding will be sufficient to allow Salix to provide its much-needed support

Earlier this year, The Informed Executive assessed the role of Salix Finance, a dedicated institution providing loan funding to the public sector for investment in energy efficiency projects that will reduce energy bills and carbon emissions. It had been set up in 2004 by the Carbon Trust and after a £4m pilot which supported 19 local authorities it received a further £20 million of Government funds for 2006-08. Salix came out of our analysis as a vital source of finance if public sector bodies are to make more efficient use of energy.

Salix makes loans which have to be matched pound-for-pound by the organisation it is assisting. The fund, which is ring-fenced and operated separately from the institution's other activities, allows capital purchases to be made that will generate significant revenue savings on energy within a carefully defined time window.

We left Salix Finance at the point where it was waiting for its next round of funding from DEFRA. Our concern was that the likely demands on Salix for funds would outstrip the availability.

Eighty local authorities in the UK were expected to join the Carbon Trust's Carbon Management Programme in 2008; if a high proportion of those put in applications of between £50,000 and £200,000 apiece it was evident that Salix would not be in a position to fund all the projects which met its previously established criteria on payback period and carbon cost.

With the new funding round complete, how did Salix Finance fare? The company's MD Alastair Keir, who took up the reins in February 2008, explained that the settlement was £30 million over three years. At £10 million for each of those years, that new package is broadly the same in cash terms as it had been in the years since Salix was established. "It was slightly less than what we had been hoping for, but in line with what we had expected", Keir admitted.

But the ground rules on which Salix Finance provides its loan funding have changed, it appears. Its DEFRA grant can only be made available to English public sector organisations. Where Salix had supported institutions in Wales, Northern Ireland and Scotland directly from its funds, new applications in those three areas have to be financed by the regional administrations.

The new arrangements increase the flexibility with which Salix can fund projects. "In the Higher Education sector, for example, we are working with universities and providing 100% of the funds required. The money is provided equally by DEFRA and HEFCE (the Higher Education Funding Council for England).

The individual universities have to top up the pot with another 25% which can be used for projects which would not have fallen within Salix' stricter boundaries of a 5 year payback

Salix Finance illustrates how activities such as data monitoring can be subsidised within the rules. Clients are allowed to add a 15% administration fee to the total cost of a project once it has passed its technical and financial assessment, and that could be used to fund staff or, indeed, advanced metering systems.

Data monitoring is a vital component of Local Authority Carbon Management Programmes, providing a powerful stimulus in their own right to the reduction of energy conumption. Display systems such as the Optimal Monitoring solution cannot be funded directly by Salix but options do exist for their purchase, as explained by Salix MD Alastair Keir.

period and a £100 per tonne lifetime cost of carbon. For the money added by the universities, the limits are a ten-year payback and £400 per tonne.

Full demand yet to show

Returning to the funding of the English local authorities, the demand for funds does not appear to have increased significantly from the previous year, despite the growing number of councils becoming involved in carbon management projects.

Alastair Keir believes there is a good reason. “What tends to happen is that sustainability teams in councils are the ones responsible for managing the carbon management programmes.

“But these have often not been the people who identify capital projects and hence would make the approach to Salix.”

It would certainly appear that in some cases teams in different directorates do not effectively communicate with each other. “The chances are that we will see a much greater demand this time next year when the local authorities who joined the scheme in 2008 have completed the LACM Programme and are about to launch their implementation plans, which need capital expenditure to support them.”

Where there may be some confusion out in the public sector is about the kind of project that Salix itself can fund. The MD cites the example of energy monitoring systems which a local authority might be looking to install so that it can determine present energy consumption in different departments and thereby gain a better understanding of where savings can be made.

As a monitoring system does not itself reduce energy consumption, funds provided by Salix could not be used for the purpose. If the same system identified that a boiler was consuming excessive amounts of energy each year, replacing the boiler would be considered for the loan as there would be a quantifiable saving in energy far into the future.

The payback period would still need to be less than five years, and the cost per tonne of carbon would have to be under £100.

Multiple interpretations

‘Creative accounting’ is not a charge that one would easily level at a government-backed finance house, but Salix Finance can point to ways in which activities such as data monitoring can be subsidised somewhat circuitously within the rules.

Keir gave an example. “Clients are allowed to add a 15% administration fee to the total cost of a project once it has completed its technical and financial assessment.

“On a £20,000 project, that would allow another £3,000 to be built into the figure, and that could be used to fund staff or, indeed, advanced metering systems. The 15% overhead effectively extends the loan repayment.”

Incentivising participants

Another option, it appears, uses an incentive illustrated in our earlier review of Salix. To keep participating organisations ‘on message’ while they spend five years using the savings they achieve to repay the Salix loan, they are allowed to retain 25% of the savings for frontline services.

On the basis of the same 5 year payback, £20,000 project, £4000 would be saved each year but only £3000 repaid with £1,000 (25%) retained.

Mr Keir came up with a third funding solution. “If a project is calculated to have a three-year payback and a carbon cost of perhaps £50 per tonne, its declared cost can be increased so that payback moves towards the five-year limit so long as the final bill does not exceed £100 per tonne.”

The fact that Salix Finance has not been overwhelmed with applications in the first few months of its new spending round is more a matter of luck than any meticulous forecasting on the part of the DEFRA mandarins.

With all the good work being done by the Carbon Trust through its Local Authority Carbon Management Programme, it is only a matter of time before the councils’ penny drops and demand for Salix funding soars. Salix should be working out now how it will cope equitably with that tide. §

It is likely that there will be a much greater demand around May 2009 when the authorities who joined the LACM Programme in 2008 have completed and will need support to implement their strategic plans