

Can Salix Finance continue to bridge the funding gap in energy efficiency projects in the public sector?



Bridging a financial gap has been the role of specialist institutions for as long as enterprises have tried to fund projects that do not fit into the conventional models of bank lending or equity. After the Second War, for example, the UK Government promoted two organisations to provide finance for business developments that fell outside banking parameters.

The Industrial and Commercial Finance Corporation (ICFC) assisted with sums as small as £5000; Finance for Industry (FFI) chipped in with sums a hundred times that level to help UK industry rebuild their asset base and restructure.

Both organisations were designed to stimulate a gear change in a business environment that had grown stagnant during the War and its aftermath.

The fact that ICFC and FFI have undergone their own transformations and re-emerged as the FTSE-100 listed investment vehicle 3i would suggest that there is always a demand for finance that helps organisations achieve goals that would otherwise be insupportable.

In their own way, the consequences of climate change and carbon reduction create a demand for unconventional funding. A hospital management might have the best intentions when it sets out to cut its emissions by 15% by installing a more efficient boiler system, but if it does not have sufficient funds in its tightly stretched budget to make the capital purchase in the first instance, the savings and the subsequent benefit are unlikely to be

achieved – even though the returns are certain to arise if the investment can be made in the first instance.

One of the vital roles of the Carbon Trust – to which frequent reference has been made in this focus – is to stimulate the infrastructure changes that will lead to energy saving and the reduction of carbon emissions. On the financial front, the Trust's contribution was to set up in 2004 a dedicated institution with a £20 million fund over a 2 year period from the UK Government to bridge the funding gap.

Applying national policy

Salix Finance is an integral part of the UK Climate Change Programme and its business model is designed to assist its clients to turn national policy into reality.

Salix is an independent company that provides funding to the public sector to invest in energy efficiency measures and technologies that will reduce carbon emissions.

The organisation is currently working with local government, the NHS and universities

and hopes to extend its programmes into central Government in the near future. By combining funding and expertise, Salix gives organisations an opportunity both to improve energy efficiencies and reduce energy costs while taking a leadership role in tackling climate change. The organisation is instrumental to the processes that public sector bodies must undertake if they are to meet the obligations imposed upon them by a combination of regulation and peer pressure.

Cost effective use of energy

Salix CEO Peter Mallaburn noted that the intervention was intended to achieve rather more than a simple energy reduction. "We are encouraging our clients to be cost-effective in their use of energy, and our investment is generally directed to that end."

The business model adopted by Salix is an interest-free loan that has to be matched pound-for-pound by the client. The amount provided is between £50,000 and £500,000, which is put into a separate fund or ring-fenced in the organisation's accounts.

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Most renewables do not qualify

Applying Mallaburn's two tests, it would follow that building insulation would normally qualify for Salix support but, significantly, most renewable energy projects would not, as they would fail the five year rule. Exceptions may include co-fired boilers and some solar thermal energy projects, but the more obvious renewable technologies such as wind turbines would not qualify. The CEO describes the target market for funding quite succinctly: "It would be fair to say that Salix provides support for low-lying fruit."

A sceptical view might be that Salix Finance only backs racing certainties, but its funding method does ensure that there is a 'guaranteed' revenue stream that can be ploughed back immediately into other qualifying projects. But there are examples of support for public bodies which can justify an investment in resources as well as energy-reducing equipment.

Funds for energy management

Energy and project management would qualify on that basis, as long as they were integral to making the investment happen; more general energy management and strategic advice is the province of the Carbon Trust. As Peter Mallaburn noted, project management is a skill-set that can be in short supply within many areas of the public sector.

Fortunately, the simplicity of the Salix approach avoids the need for ranks of accountants to manage the projects: if a new, energy-efficient boiler is to be installed for £10,000, and the project is intended to pay for itself in the full five years, £2,000 is paid back to the client's central fund each year to be available to recycle on other projects.

There might appear to be little incentive for an organisation like a school, which is desperate for additional budgets, to commit its own funds to repay a loan for a number of years. The resulting savings on energy costs, however, release long term funds to be utilised throughout the school.

Cash-back incentives

Mallaburn and his colleagues also identified a compromise which they believe provides the appropriate incentives. "We allow the end client (the school, for example) to retain up to 25% of the savings each year to spend as they wish. So, on the back of the £10,000 boiler, the client would see a return of 25% of the £2,000 a year savings. Over the five years, that £2500 would be enough to purchase extra computers or buy laboratory equipment."

Salix Finance appears to be operating to good effect across the spectrum of the public sector

Local Authorities

Local authorities have an essential role in helping to deliver Government climate change targets given their direct interface with the public through the services they provide. They have recognised the value of managing their own energy use to help reduce running costs and to help protect their communities from the impact of climate change.

Salix launched its Local Authority Energy Financing (LAEF) pilot scheme in 2004. The pilot now includes 19 Local Authorities that have completed or commissioned nearly 500 projects with a total value of £3.3 million. The announcement of a further £20 million in funding for 2006-08 has allowed the pilot to be rolled out into a fully fledged Local Authorities programme.



Southampton City Council's flagship Leisure Venue, The Quays 'Eddie Read' Swimming & Diving Complex, unveil their record breaking heat retention pool cover. The cover has ensured that Southampton City Council is being even more efficient with its methods of energy savings, and in just one month reduced costs by approximately £600. In addition, the cover will help reduce chemical evaporation and condensation.

Higher Education

Higher education institutions are responsible for emitting an estimated 1.9 million tonnes of carbon emissions and for consuming more than 7.7 million kWh of energy. Salix Finance's programme for the Higher Education sector is intended to reduce emissions in all areas where the university has an influence. These are typically academic, accommodation and leisure buildings. The UK Higher Education pilot was launched in June 2006 with a total Salix grant of £800,000 and has four universities on board.

The Higher Education pilot was launched in Scotland in March 2007 with a total Salix grant of just under £1.3 million.

NHS Foundation Trusts

The NHS emits approximately 1 million tonnes of carbon each year and consumes about 1% of the energy consumed by the whole of England. The Department of Health's mandatory target for the NHS is to reduce its carbon emissions by 0.15 million tonnes by 2010. In addition, regulation from the EU Emissions Trading Scheme (EU ETS) and Energy Performance in Buildings Directive, reducing carbon emissions and capturing cost savings has become an increasingly important issue for the NHS.

Salix has developed a programme tailored to the needs of NHS Foundation Trust Hospitals. The primary focus of the work is to reduce carbon emissions under the control of the Foundation Trusts such as heating, cooling and lighting. The Salix pilot is taking shape with four NHS Foundation Trust Hospitals starting the programme in April 2007 with a total Salix Grant of £690,000.

Collaborating with Salix Finance

Salix Finance appoints a dedicated Relationship Manager to work in conjunction with clients. The Relationship Manager acts as a key point of contact and provides assistance at all stages of setting up and managing the fund. This person can demonstrate ways by which customers can:

- Convince sceptical colleagues of the benefits of action by using energy savings to support front-line services
- Show tangible proof to stakeholders that action is being taken to tackle climate change
- Bring together and protect energy saving projects that on their own could be too small to attract support.

In addition to the financial facilities identified in the main feature on the organisation, Salix provides:

- A web-based management tool to keep track of projects and their impact
- Technical support to allow clients to choose the best projects and understand how they work
- A link to the energy and carbon management support provided by the Carbon Trust for the public sector
- A connection to the growing Salix community enabling clients to exchange ideas and experiences.

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What the Salix CEO was describing may sound like common sense to a private sector observer but it has huge implications for public finance: what has been achieved is the offsetting of a capital outlay by a revenue stream; normally a non-starter in the sector's ground rules.

Apportioning funds

With available funds of £20 million, Salix Finance is clearly more than a cottage industry. With the public sector coming under ever greater pressure to clean up its carbon act, pressure on the company's resources are likely to mount.

How will Mallaburn apportion funds between projects when there are more projects worthy of support than there are funds in the budget?

He agreed that Salix had not been resource constrained up to now. “The Carbon Trust analysis which helped establish the Salix budget suggested that some £500 million would be needed for all of the projects which might be supported over time; half of it coming from Salix; the other half being found by the client.

“Towards that global figure, we currently have commitments of £28 million and expect the amount to accelerate sharply. We have been allocating resources to date solely on the grounds of competence and a due diligence report from an independent team on the project and the authority's track record in managing funds.”

Around 800 potential clients

Investing around £10 million a year in co-funded projects, Salix now has between 80 and 100 clients. When Peter Mallaburn developed the original model for the company, he estimated that there were some 800 potential clients of sufficient size who could benefit. The



Bristol City Council used Salix to reduce car park operating costs

Bristol City Council invested £41,000 to install an energy efficient lighting conversion kit with occupancy/daylight sensors inside a multi-storey car park. This has resulted in annual saving of at least £19,000 and 95 tonnes of CO₂.

In just over two years, Bristol City Council will have reduced its environmental footprint but will continue to make cost savings resulting in additional funds being available for core services. The Council has also found that maintenance costs have been reduced due to longer lamp life and public safety improved as a direct result of brighter lighting and increased visibility.

organisation clearly has a long way to go before its objectives have been fulfilled.

So far, the number of organisations meeting the acceptance criteria has kept pace with the company's resources. The extent to which Salix Finance can meet the anticipated demand for funds in the future will be determined by the size of the financial settlement made by the Government each year.

Private sector options?

There must remain the question of whether what Salix Finance does today could more effectively be handled by private sector institutions: that would be a way of increasing the scope of this private gap finance.

Experience shows, however, that the commercial banking community was unwilling to commit to investing on similar terms without Government guarantees. That would have negated much of the benefit that the Salix model provides.

It will be interesting to see whether Whitehall takes its obligations to energy efficiency and carbon reduction as seriously as it claims. As the source of finance for Salix Finance: it directly holds the purse strings to one of the more significant enablers for its energy policies in the public sector.

If Salix Finance proves as enduring as the ICFC and FFI, it will be pivotal in the campaign for energy efficiency for a generation to come. §