



Transition Finance 2023



The
Scottish
National
Investment
Bank

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Foreword

When we talk to energy supply chain businesses in Scotland, they tell us loud and clear that they want to play their part in transitioning to a net zero energy system. But they also tell us they face challenges – specifically, a decline in oil and gas production, and lack of finance to help them make the transition.

As an impact investor, we see key opportunities for commercial finance to deliver positive impacts for the workforces and communities currently working in the energy supply chain. We believe the economic benefits of a net zero transition largely depend on the skills, workforce, and experience of many of the established businesses currently working in fossil fuel supply chains. They need support to achieve a just transition. We've already been working closely with some of them, have made investments to help them prepare, and are working hard to support more investment.

As Scotland's development bank, our role and three missions call on us to draw attention to these challenges and work with developers, business, government and other investors to solve them. This paper highlights the need for private sector investment in Scotland's energy transition to help the current energy supply chain become ready and able to serve a new, low-carbon system.

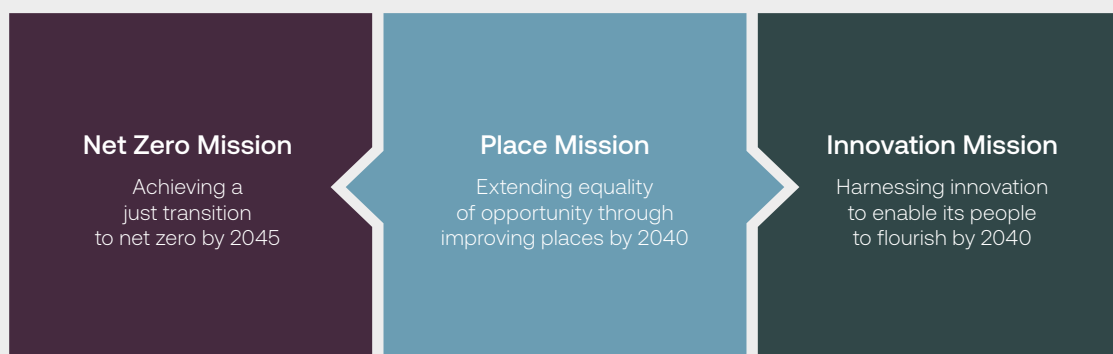
We're excited to continue this conversation and make a just transition a reality for people, businesses and communities across Scotland.

Al Denholm
Chief Executive Officer



“For transition to net zero to succeed, we need the skills and capabilities of the people and organisations currently working in the fossil fuel supply chain. A just transition means bringing them on this journey with us, not leaving them behind. And that will take long-term, strategic investment.”

The Bank's Missions





Executive Summary

Scotland has a strategic goal of transitioning from oil and gas to lower carbon forms of heat and energy to achieve our climate change targets. This paper sets out why it's important to support the current energy supply chain through transition finance, to help existing companies grow, develop and play their part in delivering Scotland's transition to a renewable, low carbon energy system.

We've identified five themes:

1. Potential growth for Scottish businesses serving an expanding renewables sector

Through the ScotWind licencing round, and by using our skills and experience in fixed-bottom offshore wind and oil and gas production in the North Sea, Scotland could be the first country to move at scale in floating offshore wind. It's estimated there is a potential £28.3 billion in supply chain spending commitment up to 2030, with up to £4.1 billion in value to be realised in floating wind.

2. Today's businesses, people and skills are critical for the transition

Delivering the energy transition requires considerable investment into the energy supply chain in Scotland. A just transition will take employees, companies and communities with us. In other words, the organisations serving today's energy system (historically dependant on oil and gas) need support and investment to serve the energy system of tomorrow.

3. Decreasing oil and gas production means revenue decline for the supply chain

UK oil and gas production is estimated to decline by 40%, from 460 million barrels today to 260 million barrels by 2030. This means contracts will be both harder to come by and smaller, so the market will become more competitive. Profits may be reduced, which in turn will impact supply chain companies' ability to reinvest in the future.

4. Investors are pulling back from oil and gas; finance is harder to find

Supply chain companies currently serving the oil and gas sector are finding it difficult to raise finance as investors shy away from climate-related balance sheet risk. This is driven by policy, regulatory and industry initiatives but has in consequence contributed to investors pulling back capital from the current energy supply chain, making it hard for transition-critical companies to source the investment they need to transition.

5. Transition finance is vital to bridge the gap and transition successfully

Targeted finance is necessary to support the existing energy supply chain in Scotland to grow and service a vastly increasing renewable energy market, whilst avoiding greenwashing. We have a clear role to play here and have set out some guiding investment principles to ensure that our approach as an investor supports a just transition.



Section 1 – The size of the prize

Energy transition is a critical element in meeting the need for pressing global climate action. Scotland has a massive opportunity to respond to this call, capitalising on our natural resources, particularly our offshore wind capacity.



For our **climate/environment** expanding renewable energy can unlock the energy transition, speeding our journey to net zero and creating renewable energy security.



For **our places**, so that no people or communities are left behind; a just transition that supports companies and communities is needed to create positive change by realising opportunities and expanding green jobs.



For **our economy** through supply chain business growth, particularly through on and off-shore wind and unlocking potential in the green hydrogen industry.

The size of the prize

41GW

41GW offshore wind pipeline between 2025-2035, up to 40% of the UK 2030 target.

£4.1bn

£4.1 billion spend on the floating wind supply chain in Scotland by 2030 – an opportunity to be world leaders and first adopters by building on current oil and gas skills.

£28.3bn

£28.3 billion current developer spending commitments in Scotland with potential to increase to £41 billion.

3.3%

Scotland currently leads UK average in green jobs (3.3% vs 2.2% across all regions)¹.

1. Green Jobs Barometer, PwC UK ([pwc.co.uk](https://www.pwc.co.uk)).



Section 1 – The size of the prize continued

Our current supply chain is our competitive advantage

Renewable supply chains have been developing in Scotland, but the scale of the offshore wind pipeline in particular requires rapid growth and the inclusion and transition of the current energy supply chain. Our existing businesses, people and skills bring huge competitive advantage as we transition from servicing the current market in oil and gas to servicing offshore wind, green hydrogen production and related infrastructure.

Scotland's advantage is built on years of skills and experience – the skills needed to operate an oil rig at sea will be useful to understand how to deliver a floating wind farm. Supporting existing employees¹ and companies will help deliver our energy transition commitments, ultimately maximising green electricity production and domestic supply chain spend. Old distinctions between different sectors of the energy industry are collapsing – we should see the supply chain as one large energy supply chain in transition.

Cross-Scotland, cross-sector

Whilst North East Scotland has the greatest opportunity to benefit from the transition, supply chain companies aren't solely located there. Across the UK, the National Grid estimates that 117,000 green jobs will be required by 2030, an additional 152,000 by 2040, and an additional 131,000 by 2050². In North East Scotland alone, becoming a Global Energy Hub may need an estimated 14,000 people to move into renewables roles, with up to 16,000 new people joining the industry up to 2030³.

The Offshore Wind Sector Deal⁴ has set wider industry goals focused on ensuring that the transition contributes to social and community benefits, including:

- ◆ Increasing UK-made components to 60%
- ◆ Creating apprenticeships
- ◆ Increasing employment ratios for women to 33% and BAME to 9%
- ◆ Introducing an Offshore Energy Passport to allow more job mobility.



“In North East Scotland alone, becoming a Global Energy Hub may need an estimated 14,000 people to move into renewables roles.”

1. An October 2020 survey of oil and gas workers in the North Sea found that even though 91% of respondents hadn't heard of the term 'just transition', 81% would consider leaving the industry to work in another sector. Over half showed interest in renewables and offshore wind (<https://foe.scot/resource/offshore-oil-and-gas-workers-views/>).

2. Net Zero Energy Workforce Report, National Grid (<https://www.nationalgrid.com/stories/journey-to-net-zero/net-zero-energy-workforce>).

3. Making the Switch, Robert Gordon University (<https://www.rgu.ac.uk/wp-content/uploads/2022/06/Making-the-switch-images.pdf>).

4. Offshore Wind Sector Deal, UK Government (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/790950/BEIS_Offshore_Wind_Single_Pages_web_optimised.pdf).



Why it has to be a just transition

Francesca Bell – Offshore Energies UK

Why is a just transition for businesses and people necessary?

The energy sector, and the industrial heartlands it supports, are part of the fabric of UK business and communities from Shetland to Southampton. This sector is a springboard for our transition to a lower carbon economy. Building on our heritage will be key to maximising the opportunities and delivering a just transition for all should leave the economy, people, and society better off than where they started and that is something we should all get behind.



What advice do you have for businesses who want take advantage of the opportunities in the energy transition?

- ◆ Define your own transition strategy - it should be dynamic, specific to your company, and forward looking.
- ◆ Prioritise your stakeholder engagement – a successful strategy should consider both your company objectives and how you influence (and are influenced) by your value chain.
- ◆ Your people are your biggest assets – a diverse and engaged workforce will be critical to maximising the opportunities of the energy transition.



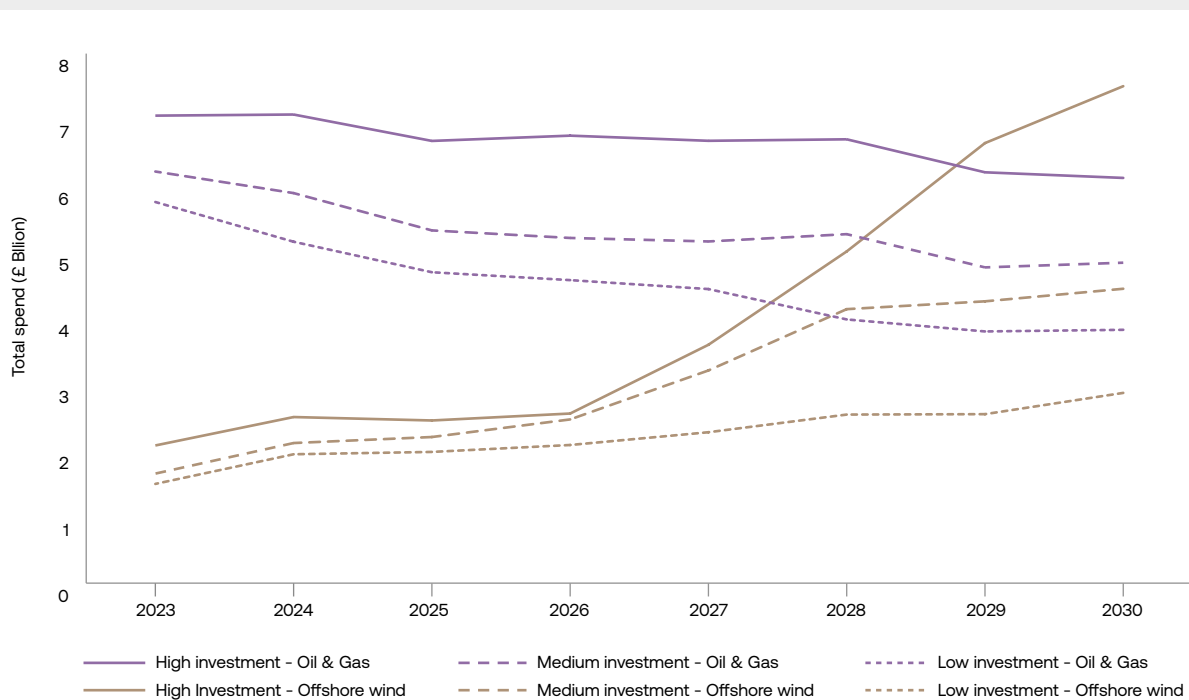
Section 2 – Current supply chain challenges

The existing supply chain, which has been reliant on oil and gas revenues, faces two core challenges – a decline in production and a decline in investment capital. Both threaten to curb companies of the investment they need to transition to service a green energy future.

Challenge 1: A decline in oil and gas production

UK oil and gas production is expected to decline by 40%, from 460 million barrels today to 260 million barrels by 2030¹. Supply chain spend will also decrease from around £11 billion in 2023 to around £8 billion in 2030 (in a mid-case scenario). While the oil and gas industry will continue to have a hugely valuable contribution to the economy for some time to come, this means contracts will be harder to come by and are likely to be smaller, so the market will become more competitive. This may lead to loss of revenue, which may then impact profits and threaten reinvestment in transition activities.

Investment scenarios for the energy sector to 2030



Source: OEUK Supply Chain Transition Report, June 2023

1. This assumes a production forecast in line with the Department of Energy Security and Net Zero's Energy Security Plan and is taken from North Sea Transition Authority (NSTA): NSTA Open Data – Data centre (nstaauthority.co.uk)



The graph opposite shows a potential £5 billion gap in the size of the future offshore wind market in 2030, depending on the level of investment achieved throughout the rest of this decade. The difference between a low investment scenario (£2.5 billion) and a high one (£7.5 billion) is the opportunity cost of accepting managed decline without stimulating the domestic supply chain. For context, Robert Gordon University estimated up to 17,000 jobs could be lost by 2030 in a low-investment scenario².

There is a critical timing issue here: oil and gas revenue decline will not necessarily correlate with an increase in offshore wind supply contracts. A viable supply chain in place at the point of final investment decisions (FID) by offshore wind operators will be crucial. This means investment in manufacturing factories, warehousing and training needs to be committed years ahead of FID. If domestic companies aren't ready to supply when developers need their products and services, the opportunity will be lost. A healthy supply chain also lowers development costs, making sure that the pipeline can be built efficiently and on time to meet our renewable energy and climate goals.

Businesses need support to bridge the gap and invest in scaling-up, ahead of the large demand that will grow rapidly from 2026-7.

Challenge 2: Withdrawing finance from oil and gas businesses

As we transition towards a green economy, energy supply chain businesses that have traditionally relied on revenues from the fossil fuel industry will need capital to pivot towards low-carbon sectors. Policy and regulation is building impetus for this to happen faster, yet, at the same time many major banks, lenders, and investors are turning away from oil and gas-focussed and energy intensive industries, which are increasingly seen as a reputational or financial risk³.

Whilst we want to see the transition happen faster, we must make sure there isn't an unintended consequence of energy supply chain businesses unable to access the investment they need to make the transition. By 2030, it's estimated every pound invested in fossil fuel supply should be matched by four pounds of investment in low-carbon energy supply². Existing supply chain businesses making the transition from oil and gas revenue to low-carbon revenue need this investment to make the transition.

In the next section, we set out our approach which aims to balance the need for transition finance with the reality of some of the supply chain's current revenue. Ultimately, we need a healthy energy supply chain ready and waiting to support the delivery of the energy transition.

2. See BNEF's report Financing the Transition: Energy Supply Investment and Bank Financing Activity (<https://about.bnef.com/blog/financing-the-transition-energy-supply-investment-and-bank-financing-activity/>).

3. The Paris Agreement, the Taskforce on Climate-related Financial Disclosures, The EU Sustainable Finance Disclosure Regulations, and the UK FCA Sustainability Disclosure Requirements require investors to manage and report on their portfolios and ensure against greenwashing (https://finance.ec.europa.eu/sustainable-finance/disclosures/sustainability-related-disclosure-financial-services-sector_en).



Section 3: Transition finance principles

To achieve our net zero mission, harnessing Scotland's core asset of experienced energy sector businesses, we will play our part supporting those who seek to transition to support the low carbon energy sector. As an impact investor with high ethical standards, we will use careful principles to make sure we're putting our capital where it has the potential to be transformative.

Our high-level principles are:

Purposeful businesses

We will seek to work with organisations that have made a clear commitment to transition, or that are committed to doing so as a result of the Bank's investment. This includes actions such as:

- ◆ Making significant transition efforts in the company's investment and strategy
- ◆ Publicly stating a strategic direction focussing on transition to renewables and clean energy technologies, or decarbonising existing fossil fuel infrastructure

Businesses may also be looking to play an active part in the broader just transition, for example:

- ◆ Training and reskilling staff from fossil-fuel operations into renewables and clean energy technologies
- ◆ Providing apprenticeships to expand the renewables-ready workforce, supporting more people to gain the skills and experience to work in the industry.

Focussed investment

We'll focus capital on energy supply chain businesses that can reach scale or deliver a wider industry impact.

We'll focus where we can do more than provide our own capital, for example:

- ◆ Providing non-financial value add to grow environmental or social impacts
- ◆ Mobilising others' capital alongside our own
- ◆ Help a business move towards future market investability.

Safeguarding the transition

Each investment will include covenants, including timelines for change, on the target minimum proportion of revenue from renewables; a shift in revenues from oil and gas; or specific targets for reduced emissions:

- ◆ Investment can be structured to encourage companies to overperform against targets, so as to further accelerate the transition
- ◆ Recognising that oil and gas will continue to be produced in the North Sea, we acknowledge in some cases, for example, to improve safety or the efficiency of production or decommissioning, it may be appropriate to maintain a percentage of fossil fuel-based revenue in the short-term.



These principles will guide our investment approach. We will engage deeply with the energy supply chain to make sure our principles deliver the impact we want to create.

We believe it's possible for investors to take robust positions that support companies to transition, while showing their positive impacts. It's clear that the sector needs capital – which is an opportunity for investors. It's also clear that, without capital, these companies can't successfully deliver the transition.

To reap the benefits for business, people and the economy, we must create the right conditions for the green energy sector through high investment. We are keen to work with other investors who see the need for transition finance for supply chain companies, and find a route through to support the levels of investment needed to accelerate a just transition in Scotland.



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