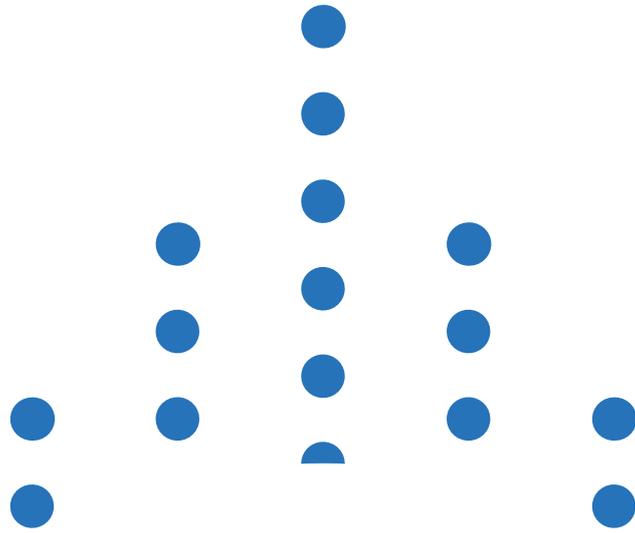


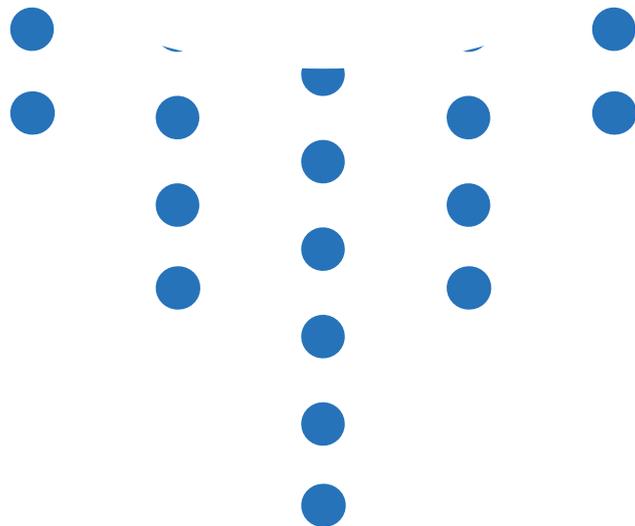


PLF Investment Readiness Publication





INTRODUCTION





About this publication¹

This publication is intended to be used by leaders of community energy groups, whether these are board members or staff, volunteers or paid. Its purpose is to help these leaders to put themselves in the best position to be able to attract the capital that they need to fund the projects that they are developing.

As soon as a community energy venture raises capital from any people or organisations who are not directly involved in the project's delivery and operation, it creates an obligation, which has moral and legal aspects, to act as a trusted steward of that capital.

While this publication does not provide all the details about what it means to act as a trusted steward, it does outline the primary dimensions of investment readiness; what issues you should consider and the skills and expertise that you need to meet your obligations to your investors and other capital providers.

This publication does not purport to provide formal advice on legal and other regulatory matters and readers should not rely on the information contained therein but should seek appropriate advice before seeking investment from external parties.



¹ The material in this publication is based on the work of the investment readiness sub-group of the Community Energy Finance Roundtable which reported to the Secretary of State for Energy and Climate Change and the Minister for Civil Society in July 2014. The report from the sub-group was drafted by Robert Rabinowitz with input from Karl Harder, Sarah Hickey, Simon Borkin, Jon D'Este-Hoare, Howard Whitehead and Philip Bazin.

What is investment readiness?

The concept of “investment readiness” in this publication refers to the readiness of a community energy venture to access capital from a bank or other provider of capital. One of the primary challenges of community energy finance is how projects can access bank or institutional debt funding on top of the equity that they raise from their community investors.

Since banks and other institutional investors are usually more demanding than community investors, a community energy venture wishing to access that form of capital must consider these requirements from the start of its project development process. Even if it is not planned to access bank finance for a specific project, it is nevertheless best practice to consider the full range of issues to maximise the likelihood of success and so that full disclosure can be made to investors of project risks and how they are being mitigated.

Whilst different financiers may differ on the levels of financial returns and social impact sought from their investments, projects will always need to meet three broad criteria before being considered investment-ready:

- **Bankability:** projects have **identified and mitigated all material risks** such as equipment failure, poorly drafted legal agreements, accidents, insolvency of counter-parties and inadequate financial modelling.
- **Governance:** projects have a governance structure that ensures that **assets are managed in accordance with appropriate standards**.
- **Community engagement:** evidence that the project has the support of, and will benefit the community in which the project is based.

It is possible to have some of these components without others, e.g. a bankable project from a community energy venture with strong governance but lacking community support or a bankable project from a community group that has strong community support but that has weak internal governance. To be truly investment ready, a community energy project must score strongly on all three dimensions.



Bankability

The concept of “bankability” refers to how acceptable a project or other investment proposition would be to a commercial finance provider, such as a bank or an investment fund. Bankability is particularly important for projects that are seeking non-recourse project finance.

An example of non-recourse finance is a loan that might be made to a community energy venture that is building a community wind-farm. The community energy venture might set up a Special Purpose Vehicle (“SPV”), a legal entity that owns all the assets connected with the wind-farm, including the turbines, the equipment that connects the wind-farm to the grid, the planning permission, all the supply and servicing contracts and the cash generated by the project before it is distributed back to the investors. An SPV is so-called because the only assets that it owns are related to the wind-farm. It does not hold assets or take on liabilities that are not directly connected to the wind-farm.

If a bank or other finance provider is approached to provide a loan to the SPV, this will normally be on a non-recourse basis. This means that the only assets to which the bank can have recourse to ensure that it gets paid back are those held within the SPV. If the wind-farm does not generate enough money to service the loan, the bank cannot seek to be compensated by seeking repayment from a different legal entity. It cannot, for example, seize assets owned by a sister community energy venture, even if that sister venture shares board members, staff and investors with the SPV. Given that the bank can only have recourse to the assets in the SPV and cannot rely on a guarantee from another potentially financially stronger entity, before committing to the loan the bank will focus on identifying and mitigating all material risks inherent in the project and satisfying itself that these risks have appropriately identified and mitigated.

There are a multitude of possible risks. Equipment failure is an obvious example. If the wind turbines fail or are not efficient at converting the wind's energy into electricity, then the SPV will not receive the expected level of income from the sale of that electricity or the feed-in tariff. If the wind-farm is poorly constructed, vibrations from the turbine might weaken the footings, meaning that additional capital has to be spent in repairs. Poorly drafted legal agreements may enable suppliers to avoid meeting their obligations in full or enable a landlord to prematurely terminate the wind-farm's lease. If the company buying



the power from the SPV becomes insolvent, it will be unable to pay for the power and it may not be possible to find another buyer willing to purchase the power on equivalent terms. A poorly constructed financial model could present a significant risk. If the formulae in the spreadsheet are not correctly constructed, the actual cash-flows into and out of the project could be materially lower than forecast, resulting in inadequate cash to repay loans.

In order to provide non-recourse finance, banks will need assurance that all appropriate risks have been identified and mitigated. Risk mitigation methods include the use of suppliers or advisors with a strong track record. For example, the bank may only sanction lending to projects that use equipment manufactured and installed by specified suppliers who have got an established track record and can provide verifiable data on how their previous equipment and installations

are performing (a “white list”). On top of that, the bank will likely seek various forms of guarantee or warranty relating to the quality of the equipment and its future performance and output. For the bank to be satisfied with such guarantees it will want to make sure that they are reviewed by legal or other advisors to ensure that there are no loopholes and that the terms meet market standards. The bank will also want to review the accounts of the manufacturers or installers to ensure that they are well placed financially to meet their obligations if the guarantees are called upon. The bank might also insist that such guarantees are backed up with insurance from an insurer of sufficient financial strength.

Banks will seek assurance that all material risks have been identified by relying on legal, financial and technical advisors. This means that if the project being financed does not perform as expected, the bank can potentially seek redress from these advisors who will thus need to have adequate professional indemnity insurance to meet the potential liabilities to which they may be exposed if the project on which they give assurance fails to perform as expected.



A “bankable” project is thus one that a bank or other provider of commercial project finance would, in theory, find acceptable from a risk mitigation basis, i.e. it would be comfortable that all material risks have been identified and appropriately mitigated. While different finance providers may approach project finance in a similar way, bankability is not always a black and white issue and finance providers may differ in their approach to specific risks.

This document does not provide an exhaustive list of the criteria of project bankability, but they are likely to include:

- **Agreements required to construct the project**, i.e. planning permission (where required), grid connection, legal agreement with the owner of the property on which the project will be located, other consents such as environmental impact assessment, hydrology studies.
- **Use of equipment of adequate quality provided by reputable manufacturers.**
- **Use of suppliers**, e.g. installers, providers of monitoring and maintenance, with sufficient expertise, experience and balance sheet.
- **Use of professional advisors**, e.g. lawyers, technical advisors, with sufficient expertise, experience and balance sheet.
- **Legal agreements**, e.g. leases, installation and maintenance contracts, power purchase agreements, which give sufficient protection to the community group.
- **Corporate structure that allows the lender to take security.**
- **Adequate financial returns as projected by a financial model that has been audited by an independent expert.**
- **Insurance and warranties from credit-worthy entities.**
- **Power purchase agreement from a credit worthy counter-party.**

Bankability can present at least two challenges for community energy companies. First, since community energy companies are often run by people without significant direct experience of renewable energy project development, projects may be designed in such a way that reduces their bankability, e.g. use of a supplier with which the bank is not comfortable or use of contracts that do not provide enough legal protection. This problem is exacerbated when project proponents

only decide to seek third party finance relatively late in the project development process, by which time decisions that reduce the bankability of a project may be hard to reverse.

Second, the traditional project finance approach can increase the up-front costs of a project considerably, through the use of approved suppliers who may be more expensive and through legal and other professional fees. Community energy projects may be ill-placed to meet these costs because they can often only raise capital after bank finance has been approved and so do not have access to the funds up-front. Also, the additional costs required to achieve bankability are often disproportionate for smaller scale community energy projects.

Although it can be argued that all community energy projects should be bankable before seeking any external investment, many community energy companies have raised money solely through community share issues for initial projects that would not be considered bankable. However, for community energy companies that wish to scale up, access to debt becomes increasingly important because community equity cannot provide all of the required capital. It is these community energy companies in particular that face the challenge of bankability.

For community energy groups participating in shared ownership with a commercial developer, many of these elements of bankability will already have been addressed between the commercial developer and its funders. Nevertheless, community energy groups will need to have access to some of the necessary skills in order to assess the bankability of the project for themselves and to negotiate with developers on financial and other matters.





Making a project bankable

Many community energy ventures lack awareness of the requirements of banks and financial institutions. A relatively common scenario is that a community energy venture only realises that it has a need for bank or similar types of finance relatively late in the project development process, by which time decisions have already been taken which have impaired the project's bankability. It is therefore of crucial importance that bankability requirements are built in to the project from the beginning.

The first step to making a project bankable is also the easiest step. Seek out people with expertise in renewable energy finance and get their advice on the relevant risks and how they can be mitigated. You should preferably ensure that the leadership of your organisation includes someone with enough expertise to have these conversations and to make a judgement on how to apply the advice that is received.

A major challenge in making a project bankable is that community energy ventures often lack the funds to secure required professional and technical advisors of sufficient quality and expertise, especially early on in the project development process. Fortunately, there are several government-backed sources of finance that are available to meet these costs including the Rural Community Energy Fund and the Urban Community Energy Fund in England, the [name] programme in Scotland and the [name] programme in Wales. These programmes provide grants and contingent loans to community energy groups to enable them to access professional support that they could not otherwise afford ahead of a community fund-raise.

However, there is a risk that the services purchased using these funds will not be acceptable to financial institutions because the selected professional advisor may not be acceptable to financial institutions or the advice may not have been procured to an appropriate scope or under terms that make the advisor fully liable for the advice provided.

In order to avoid this pitfall, you should seek out advice on which professional advisors are most likely to be acceptable to finance providers. Do not simply use a local professional advisor simply because you already have a relationship with that person or because they are offering the

lowest price. The most important criteria to use in selecting an advisor is their experience in doing similar projects before, especially if they have provided advice to projects that have received finance from banks or similar capital providers. Once you have selected advisors, it is important to ensure that they are instructed using appropriate scopes of work and on terms that give you adequate protection. The CARES programme in Scotland provides standard scopes of work. Alternatively, seek advice on how to instruct your advisors from the operators of the RCEF or UCEF funds.



Governance

In addition to looking at the bankability of a project, a finance provider will want to look at the governance of the community energy venture developing the project or that will eventually own the project. After all, the finance provider will have a relationship with the community energy venture, and be exposed to risks relating to its operation, for many years until the finance is fully repaid.

Community energy ventures can face particular challenges in relation to this issue because they may operate without full-time professional staff and/or rely on volunteers or board members who may lack experience of renewable energy project development.

The following are criteria by which finance providers may assess the investment readiness of a community energy project from a governance perspective:

- *Vision and understanding* – Does the leadership of the community energy group have a sufficiently ambitious, clearly articulated and shared vision and an understanding of the practical work involved to get there? If not, there is a significant risk that the group will not persevere to the point at which funds can be drawn down.
- *Adequate skills* – Does the leadership of the community energy group have sufficient knowledge and experience to take a project through to completion? The leadership should include several people with strong skills to ensure that the company does not become simply the mouth-piece of one person. It is, unfortunately, not uncommon for community energy groups to have aspirations that they lack the expertise to realise. Below is a short list of some of the key skills required from the leadership of a community group:
 - Legal
 - Accounting
 - Technical, e.g. renewable energy, power generation, engineering
 - Communications, e.g. media, public affairs, community engagement
 - Project management
- *People with sufficient time to devote to the project* - It is also important that the leadership of the group not only has the skills but actually has committed enough time for the community energy group to benefit from them. Finance providers are unlikely to be able to work successfully with community energy groups that do not have people able to respond to requests for information and other tasks in a timely fashion, rather than getting work done only at the weekend or during holidays.
- *Willingness to be guided by experts* – However skilled and knowledgeable the leadership of a community energy venture, any successful project will require expertise from external advisors, whether that is from more experienced community energy groups or professional advisors retained to address specific issues. A



community energy group that does not allow itself to be guided by those with greater experience and expertise will not be investment ready as they are likely to impose greater transaction costs that will be unaffordable either for the finance provider or the group.

- *Good quality management and procedures* - A clear management structure with clearly defined roles. Organisations should be properly incorporated, material decisions should be taken by the board and recorded in minutes, with other decisions delegated by the board to specified people. There should be financial controls, ensuring that the organisation cannot use its cash or make financial commitments without appropriate approval procedures having been satisfied. There should also be clear and auditable financial record keeping, with relevant information submitted to regulators appropriately, and records of external interests of team members. It is also crucial to ensure that any apparent or real conflicts of interest are identified and that procedures are put in place to address them in a robust way.
- *An agreed vision for how profits will be used to generate social and environmental impact* – The issue of social impact is growing in significance because the access of community energy ventures to various financial and regulatory incentives, such as Social Investment Tax Relief, is dependent on those ventures being able to demonstrate that investment into community energy delivers greater social impact and community benefit than a purely commercial venture. From a social impact perspective, a community energy venture should have a target population or community for which it wishes to generate benefit, e.g. people in fuel poverty, NEETs or the unemployed. It should have undertaken research into the needs of this target population and what benefits the venture may realistically be able to achieve. The case for social impact will be strengthened if the venture has identified partner organisations with acknowledged expertise in addressing the needs of the target populations and has incorporated representatives of or advocates for these populations into the governance structure of the venture.



Community engagement

Community engagement, of course, is what distinguishes community energy projects from standard renewable energy projects. There is no exact definition of what constitutes community. In the Community Energy Strategy, the Government defines “community energy” as projects that involve community ownership, leadership or control where the community benefits. The term “community” includes communities of place and communities of interest. Other aspects of such projects are:

- sharing of financial benefits with the broader community
- a focus on social outcomes as well as financial benefit for shareholders
- energy generation as part of a wider interest in sustainability, ideally supporting ongoing energy-related activities

Although community energy organisations and their boards need not be democratically representative of the community, a successful community energy project will use community engagement to achieve the following goals:

- **Broad support in the community for the project.** If sufficient community support is generated, it may be that there is no local opposition to the project. If such opposition does emerge, community support may need to be mobilised to counter that opposition.
- **The community as a source of board members and volunteers.** For a project to be successful, it must break out from the closed circle of initial founders and become open to participation from other members of the community. A community engagement programme is likely to attract and inspire people with the right skills who wish to devote time and effort to the project. This perhaps the best way to ensure that your organisation has the strongest possible team on its board and as staff and volunteers.
- **The community as a source of investment capital.** A successful community energy project is one that raises equity through a local share offer where appropriate. A well-executed project that lacks community support is likely to struggle to raise the amounts of equity required to match loan finance. Fewer local investors

also means less local impact in promoting sustainability.

- **Understanding the needs of the community.** Community engagement will help a community energy group to understand the social needs in their community that they can help to address. This is particularly important for projects which generate funds to be invested in the community.

To become “investment ready” a community energy project should have executed a community engagement strategy consisting of the following components:

- Organising or participating in public events to generate support and to identify volunteers and potential board members.
- Coverage in local media and/or distribution of specific publicity material, to spread the word and generate support.
- Development of a mailing list using emails and contact details collected from events.
- A supportive relationship with the relevant local authorities who often play a crucial role in providing back-up, making introductions, providing funding or properties on which to locate a community energy project.
- Good relationships with key local groups such as churches, the Women’s Institute, sports clubs, Rotary.





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