Community Ownership Models

July 2018

Snell Bridge

Snell Bridge

- Edinburgh-based corporate finance business founded in 2012
- Energy focus including renewables, energy storage, heat, peaking power, energy technologies
- Delivery partner for the Scottish Government's Community And Renewable Energy Scheme (CARES) programme, providing financial advice to communities developing renewable energy projects
- UK & European client base
- Authorised & regulated by the UK Financial Conduct Authority

Ownership Models

Scottish Good Practice Principles

1. Community benefit for onshore wind should be the equivalent of £5,000 per MW per year for the lifetime of the project

2. Community benefit can include:
   - Benefits from undertakings related to the development, e.g. infrastructure
   - Wider socio-economic benefits e.g. job creation
   - Benefits derived from community ownership
   - Voluntary payments to the community, usually an annual cash sum
   - Other voluntary benefits, e.g. direct project funding or ad-hoc funding

3. Shared ownership should be considered, explored and delivered as standard

4. Shared ownership should be considered differently to community benefit funds

Principal Models: Summary

Shared Ownership / Joint Venture

- Set up at an early stage
- Development risks and rewards fully shared
- Community's financial contribution may be funded by a government grant or repayable loan
- Alternatively, a community could buy in to a project after development has started by contributing a share of the costs to date

Shared Revenue

- Community invests in the project at the start of the construction period or shortly after commissioning
- Investment price is a proportion of development and construction costs
- Community earns a percentage of revenue determined by its investment

Split Ownership

- The project (usually a wind farm in this case) is divided into two parts, with different organisations owning different turbines
- Legally complex
- Higher risk than other options, particularly if community only owns a single turbine

Traditional Community Benefit

- Wind farm owner makes a fixed annual payment to a community fund
- May be in addition to other options outlined here
- No investment required
- Lowest risk option
- May be possible to convert future benefits into equity ownership

Principal Models: Advantages And Disadvantages

Shared Ownership / Joint Venture

- ✓ Likely to offer the highest returns to the community
- ✗ Community's income likely to be volatile; any finance raising must take this into account
- ✗ Community's level of control likely to be limited to "reserved matters"
- ✗ Likely to require ongoing community resource to manage relationship and forecast income

Shared Revenue

- ✓ Clear and simple structure, which should be easy to administer
- ✓ Community ranks ahead of senior lender, so income should be quite stable
- ✗ Ongoing resource required to forecast income
- ✗ Control likely to be limited
- ✗ Negotiation required, as developer may wish to deduct costs from community's income

Split Ownership

The same as shared ownership, plus:

- ✓ Possible presentational benefit in community owning specified wind turbine(s)
- ✗ Increased risk to the community if designated turbine stops operating
- ✗ Very complex to structure – warranty arrangements, operations & maintenance costs, metering, revenue and cost allocation…

Traditional Community Benefit

- ✓ Very low risk
- ✓ Very simple to administer
- ✗ Likely to have the lowest returns

Shared Ownership Example

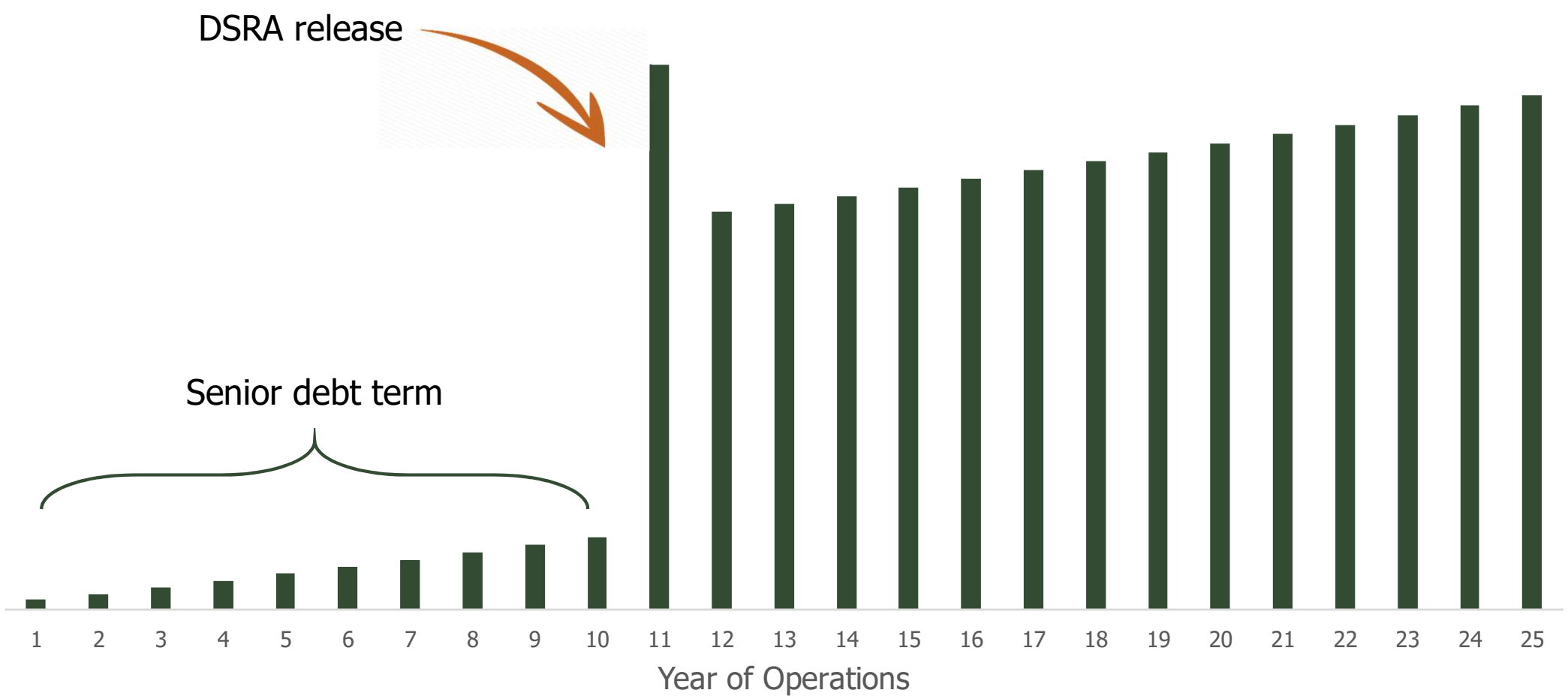
Example: Unsubsidised 60 MW Wind Farm

Senior debt
50% x £72m = £36m

Sponsor equity
75% x 50% x £72m = £27m

Community Equity
25% x 50% x £72m = £9m

Typical Wind Project Cash Flows



Project Returns

- Equity returns over 25 years are likely to be in the range 6-10% (IRR) for unsubsidised projects
- The majority of the returns will come after the senior debt has been repaid, implying that the initial annual equity returns will be substantially lower than 6-10%
- In order to invest in a project of this type, the community will need to find funders who are willing to accept a comparatively low rate of return

Other Considerations For Communities

Subordination	• Community funders will rank behind senior debt, which means that the senior debt interest and principal will always be paid before the community's lenders
Lack of control	• It is likely that the majority owner will wish to retain overall management control, limiting the ability of the community to influence the operation of the asset
Lack of security	• A project finance lender will have "step-in rights", allowing them to take control of a project if it underperforms • Any lender to the community will be able to take ownership of the community's share of the asset (but see Lack of Control above)
Volatility	• The senior debt repayment schedule will be fixed • Any shortfall in revenues will therefore impact the community's lender(s) before impacting the senior lender • This implies that the cash flows to the community are likely to be volatile, particularly during the senior debt term

Sources of Funding

Developer Loan

Summary	• A developer may provide a loan, either from the project company or from another group entity, to allow the community to invest in a project
Cost of funding	• Typically 6-10% interest rate • Mezzanine debt, ranking behind senior debt but before equity
Term	• Negotiable, but typically around 10 years
Funding amount	• Negotiable, and depends on project and community participation
Advantages	• Likely to be inexpensive to put in place • Limited due diligence requirements
Disadvantages	• Potential for conflicts of interest

Commercial Loan

Summary	• Loan from a senior lender on either asset finance or project finance basis
Cost of funding	• Typically 3.5% to 7% • Interest rate depends on project size, technology, revenue streams, funding structure • Up front costs typically 1-2% of loan amount
Term	• 5-15 years
Funding amount	• £1 – 100+ million
Advantages	• Low cost • Well developed funding market
Disadvantages	• Can be expensive to put in place, particularly project finance, due to due diligence requirements

Social Impact Investors

Summary	• Social impact investors such as Esmée Fairbairn, Social Investment Scotland, Big Issue Invest and Charities Aid Foundation have funded community energy projects
Cost of funding	• Typically 4 – 6% interest rate • Mezzanine debt, ranking behind senior debt but before equity
Term	• Typically 5-10 years
Funding amount	• Typically £0-5m • Larger funding amount may be possible from a "club" of investors acting in concert
Advantages	• Social impact investors can lend at lower rates than other lenders as their mandate includes social benefits • Lenders often quite flexible if debt needs to be reprofiled
Disadvantages	• Potential for conflicts of interest

Community Share Offer

Summary	• Sometimes also called community bonds or community debentures • Relatively common way to raise capital for renewable energy projects
Cost of funding	• Typically 4 – 6% • Up front costs typically around 5% of the funds raised • Ongoing costs from shareholders communications, administration, etc.
Term	• 10-20 years is fairly common, but can be open-ended
Funding amount	• The largest examples to date have typically raised £1-5 million, although larger amounts have been raised for land buy-outs
Advantages	• Offers local investors the opportunity to participate in the project • Potentially a low headline cost of finance
Disadvantages	• Lack of certainty – up front costs may be incurred with no guarantee that fundraising target will be achieved, or on what timescale • Ongoing costs scale with number of shareholders, so a large fundraising will be expensive to administer • Potential regulatory risk

Local Authority

Summary	• A local authority could either invest directly or provide a loan, funded either from internal resources or from the Public Works Loan Board (**PWLB**) • Local authority may need to be directly involved in the project as developer or shareholder
Cost of funding	• Likely to be low cost, c. 2-3%, if local authority funds project directly • Alternatively, local authority could borrow from PWLB and on-lend to the project at a slightly higher rate
Term	• Likely to be flexible, potentially very long term
Funding amount	• Likely to be flexible
Advantages	• Low cost, fixed rate finance • No apparent limits regarding term or funding amount • Potentially a route to financing post-subsidy projects
Disadvantages	• Very unusual, with only one clear example in UK • Structure would need careful investigation for e.g. State Aid issues, PWLB lending criteria, etc. • Risk sits ultimately sits with local authority

Case Studies

Wester Derry

Project	• 250 kW wind turbine in Kilry, Glenisla, Angus
Developer	• A&D Ramsay, a local business and landowner
Community group	• Newly-formed co-operative • Co-op has 180 members and owns 100% of the project
Community funding	• £850,000 raised via a community share offer (Sharenergy) • The fundraising took approximately 6 months to reach its target
Community benefits	• Enhanced community benefit of up to £20,000 per MW to be paid to two local primary school support groups

Allt Dearg

Project	• 10.2 MW wind farm (12 turbines) in Argyll
Developer	• Allt Dearg Wind Farmers LLP, a group of six organisations including the two landowners, two equity partners, a renewable energy developer and the Ardrishaig Community Trust (ACT)
Community group	• ACT, via a trading subsidiary • ACT owns a 1/12 share in the partnership
Community funding	• £300,000 non-recourse loan raised from the Co-operative Bank • The purchase price was agreed prior to the planning process and was calculated as 1/12 of the projected construction cost • The cash investment requirement was reduced because ACT was able to provide wind data from a previous application to the project developers free of charge
Investment structure	• The community originally approached the developers with the intention of owning a discrete turbine, but it soon became clear that it was more practical to own 1/12 of the overall project

Neilston Community Wind Farm

Project	• 10 MW wind farm (4 turbines) in East Renfrewshire
Developer	• Carbon Free Developments, a renewable energy developer
Community group	• Neilston Development Trust (NDT), via a trading subsidiary • NDT acquired a 26% share of the wind farm in return for contributing the same share of the construction equity requirement
Community funding	• Loans from social investors including Big Issue Invest, Social Investment Scotland, Charities Aid Foundation and West of Scotland Loan Fund (£950,000 in total)
Other notes	• The whole project was sold to an investor in 2017, and NDT sold its share as part of this transaction • After repaying its remaining loans, NDT was left with £2m in cash • This was used to establish a new legacy fund (independent of NDT) to support ongoing community initiatives in the Neilston area

Stewart Energy

Project	• 3.9 MW wind project (3 turbines) in South Lanarkshire
Developer	• Stewart Energy, a farm business
Community group	• Lesmahagow Development Trust (LDT) • LDT owns 25% of the project
Community funding	• LDT secured funding from the Renewable Energy Investment Fund (REIF) • This was structured as a mezzanine loan to the project company, with the interest costs shared amongst all shareholders
Community benefit	• In addition to the dividends from its shareholding, LDT also receives a community benefit payment of £10,000 per MW • LDT intends to use this income to buy allotments, fund youth training schemes, buy shops to provide local facilities and employment, establish sports facilities and buy and let local properties to provide affordable social housing

Cambridgeshire Council

Project	• 12 MW solar farm (60 acres) in Cambridgeshire
Developer	• Cambridgeshire Council
Community group	• Not applicable
Community funding	• Cambridgeshire Council borrowed £10 million from PWLB • Interest rate 2.63% • Loan term 25 years
Community benefit	• Cambridgeshire Council will make an estimated return of 7% • £350,000 per annum income during loan term; £1,000,000 per annum thereafter • Income will be spent on front line services for local residents

Thank You!

Contact Details

Simon Robinson
07967 107 509
simon@snellbridge.com