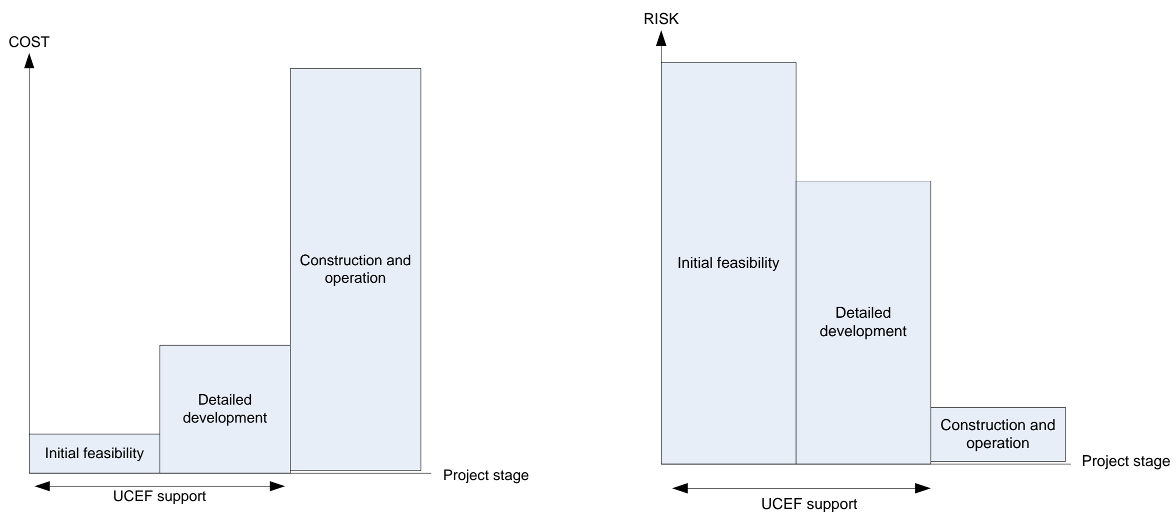
Urban Community Energy Fund – Getting your project 'investment ready'

What is 'investment readiness', and why does it matter?

'Investment readiness' is when your project is at the right stage to secure a bank loan or other investment such as shares that will cover the costs of constructing your project. You may hear people refer to such bank finance as '**debt**' and to any money you raise from shares as **'equity'** in this context.

Through UCEF, the government can provide your organisation with a grant of up to £20k, followed by a **contingent loan** of up to £130k to cover the most risky (development) stages of your project. If your project cannot proceed, for example if technical studies or planning barriers show that it isn't going to be possible, then you don't have to pay the contingent loan back.

The cost of actually building your project will far outstrip the cost of developing it but, as you can see from the two diagrams below, the building stage is by far the lowest risk. As such, it is easier to access finance for it. By using the UCEF grant and loan to cover the risky parts of your project development, it is then much more likely that you can raise all the funds you need to build a profitable community renewable energy business, since any future investors can have confidence in your complete business plan and predicted income generation figures.



Being 'Investment Ready' means you will be at the stage where you can secure either enough equity to cover the costs of building your project or, more likely, a combination of equity *plus* debt. The cheapest and lowest risk form of debt that you take on from a bank at this stage is that which is secured against the future income stream of your project, and is known as **non-recourse project finance.**[1] Projects need to be of a certain scale before you can access this sort of finance, which is explained in more detail later in this document.

[1] It's important to note that **UCEF cannot provide funding towards the building and installation stage of your project.** Legislation on State Aid prevents renewable energy projects that have been physically purchased and installed with public money (e.g. UCEF support) from claiming income from the Feed-in Tariff (FiT) or Renewable Heat Incentive (RHI). Being unable to claim either could make your project financially unviable.

How can I ensure our project is investment ready?

When you apply for a bank loan, the bank will want to see evidence that your project is not a risky investment for their money.

The UCEF process is designed to help you build up a portfolio of evidence that will satisfy the requirements of bank lenders. This portfolio will focus on five main areas:

1) **Are you a safe borrower for their money?**

Can they validate your identity? Do your directors have a good credit rating? If your group has run projects in the past, how has it performed? Are your accounts in good health?

2) **Will your project perform well financially?**

Does your technical feasibility study demonstrate sufficient likely income from your planned installation? Is your projected income high enough to cover repayments and maintenance?

3) **Are you using credible advisors and suppliers?**

Did you use credible advisors who were appropriately qualified and experienced for your legal documents, technical studies and other preparatory work? Can you demonstrate that you will use appropriately qualified and experienced suppliers for the build phase, and subsequent maintenance and management contracts?

4) **Have you secured a suitable lease on the land or building where your installation will be?**

Is there a legal agreement that protects your rights to build your planned installation on the land or building? Is your project protected from any change of heart by the landowner?

5) **What will the social benefits of your project be?**

How will the local community benefit from your project? How will you make sure that everyone in the community benefits in some way – including low income households and people who do not buy shares?

Generally, the first four areas on this list are common to all lenders but you will need to be prepared to consider the fifth for some lenders as well. Different lenders will have different requirements for their loans, particularly around social benefits, where some lenders are restricted to lending only to projects that can demonstrate positive social impacts.

The **credibility of advisors and suppliers** is a very important point where community projects often fall down. This problem is most likely to occur if you have knowledgeable people (including professionals) in your group who think they have sufficient skills and knowledge to deliver a study or legal advice, but may not have exactly the right credentials. A common example might be taking free legal advice from a solicitor within your community group whose professional work focuses on an unrelated area of law.

This is why your application to UCEF will ask you questions about who you will commission to help with your project, so that we can help make sure their advice will be accepted by a bank.

What if we are planning to issue shares instead of getting a bank loan?

You should look to develop your project along the same standards of professionalism as you would need to access non-recourse project finance, even if you are intending to raise all your money via a share issue. Shareholders will need robust assurances that they are investing their money in a project that is viable and has minimised risk where possible. Your group has a legal responsibility not to mislead people into investing in your project without being given sufficient information about the risks involved. The principles described above will help you to do this, regardless of whether you choose to use a share issue, a bank loan, or a combination of funding sources.

Financing your project via 'Non-Recourse Project Finance'

For larger projects, there is the possibility of accessing what's known as '**non-recourse project finance'** (often referred to as simply 'project finance') from a bank. This has the distinct advantage of treating the project itself (and its future income from selling energy at a premium) as security for the loan (hence 'non recourse' because the bank doesn't have recourse to any other security apart from the project itself).

Most banks don't do this complex sort of finance for projects costing less than £30 – 40 million. But some specialist lenders have adapted the techniques and developed their understanding of the sector to enable them to provide project finance for projects costing as little as £1-2 million. In all cases, the project would still need other funding – usually equity investment – of at least 30% (and potentially more for financially weaker projects).

Project finance involves the bank going through a very careful process of 'due diligence' where they – and their lawyers – review all of the documentation and contracts to make sure the risks and liabilities are understood and appropriately arranged. This covers rights to use the land on which the project is sited (and to get to that land), construction contracts, equipment supply contracts and warranties, the power purchase agreement (with whoever has agreed to buy the energy output), the structure and governance of the company, operation and maintenance arrangements, planning permission and any associated conditions. And the bank will pay an engineering consultant to assess whether the design and expected output of the project is sound.

If this all stacks up, the bank will put in place legal rights to 'step in' to all of these contracts to take over the project if the company fails to repay the loan. The company's shareholders will lose their equity investment, but the bank takes the risk that, in such circumstances, it will be able to sort out the project and recover its loan from the continued operation or sale of the project.

Financing your project via secured loans or equity

If you develop a project with a total cost of below one or two million, it is unlikely you will be able to secure non-recourse project finance because it is simply not cost-effective for banks to carry out the due diligence required for what are (to them) small sums of money. However, it is still possible for you to develop a convincing repayment case because you will be generating income from selling energy at a government-backed premium price, via the Feed-in Tariff or Renewable Heat Incentive, and this income should exceed the project costs. If you want to borrow money from a bank for a smaller project, you may therefore still be able to do so, but you will need to provide security to cover the full value of the loan in case you cannot make the repayments.

The bank will not be interested in treating the equipment of the project itself as the security (they don't want a non-functioning wind-turbine!). They will instead most likely look for other security in the form of land, or a building, which they could repossess and sell if the loan wasn't repaid.

It may be that the community could offer such security, but you need to be very clear that this would introduce the risk of losing, say, your community building, if the wind doesn't blow as hard as you expected or the equipment needs lots of repairs or the government changes the rules for supporting renewable energy project energy sales. In reality, few communities are willing to take these sorts of risks with their assets.

With projects of this sort of scale, it is therefore likely that most, if not all of the income that you raise to build your project will be in the form of equity – people will buy shares in your project. Equity investors recognise that their entire investment is at risk. Because it is the riskiest sort of lending, equity investors often expect higher returns than a bank would on a loan. This could have the effect of reducing any surplus you might generate for a wider 'community investment pot' from your project, and could mean that much of your project's income is taken up in paying shareholder dividend. This is not necessarily a bad thing if most of your shareholders are local people who have risked their own savings to invest in the project. But it will invariably be the case that there are some local people who were unable to invest directly and who will therefore not directly benefit from the project.

Isn't debt a bad thing?

Many communities are wary of bank loans because of a strong aversion to debt, often related to the tendency to think of debt in personal finance terms (like mortgages and other secured loans). From the above it should be clear that non-recourse project finance in particular is a rather different thing and can provide a sensible and cost-effective way of financing your project.

There are three key reasons why you might want to consider debt finance as an alternative or as a complement to a share issue or other fundraising:

- **Debt is usually cheaper than equity.** A community group that raises £1 million from a share issue will probably need to pay around 7% in returns to their investors, but potentially as low as 5% interest on a bank loan. This frees up more profit to be used for the benefit of the community.

- **Debt finance can provide funds that a local community may otherwise not be able to afford.** If you are setting up a project in a low income neighbourhood, you may find it difficult to raise funds from local people through shares. And you may feel uncomfortable with selling more shares to people who do not live locally, because profit from your project will flow outward from your community to wealthier neighbourhoods.

- **Debt finance can help prevent your project exacerbating a 'haves' and 'have nots' split within your community.** Your **whole** community is hosting your renewable energy installation. If some people in your community feel excluded because they cannot afford shares, this can undermine support for your project, and may have unintended consequences for social relations within your community.

Your community group **must** be incorporated to consider a bank loan. Not only will you struggle to get a loan without incorporation, it is also very important because it protects individual members of your group if something goes wrong. You can read more in our Introduction to incorporation.

Department of Energy & Climate Change

Centre for Sustainable Energy

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The UCEF team can give you advice to help ensure your project is ready for investment.

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