

Commercial Advice for Shared Ownership Models

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1 Joint venture

Typically a joint venture model involves the community investing for shares (or their equivalent) in the special purpose vehicle (SPV) established by the developer for the project in question. The principal documents that will regulate the relationship between the developer and the community will be joint venture agreement and (where the SPV is a limited company) the SPV's Articles of Association. For the community acquiring shares in the SPV gives it a tangible stake (i.e. the shares) in the project and in many respects raising the finance to invest may be easier to acquire from conventional sources such as banks than the other shared ownership models.

Key issues

(I) Timing of investment

The timing of the community's investment in the SPV will vary from project to project and will likely reflect the level of risk and involvement in the project that the community wishes to take. The later the community invests in the SPV the less risk will be associated with the project, so if, as is often the case, the community invests on or after financial close (i.e. when the project finance to fund the construction of the project is secured) the risks associated with initial project feasibility and obtaining planning consent will have been removed and the developer will expect the community to pay a higher price for its shares in the SPV. Conversely if the community invests in the SPV at an early stage in the project e.g. before a planning application is submitted then there will be a greater degree associated with the project and this should be reflected in the amount the community would expect to have to pay for its shares.

From the developer's perspective early investment in the SPV by a community serves to reduce the level of funding the developer is required to commit to the early stage development of a project albeit that it will expect the community to pay proportionately less for its shares at this stage reflecting the higher level of risk associated with the project at that time. The potential downside of early community investment for developers is that time and resource devoted to the community investment in the SPV may slow down the progress of the project itself.

In practice unless the community body already has access to funds to invest in an SPV and depending on the size of the investment, the community body is likely to need time to raise funding to make its investment which will in turn reduce the likelihood of the community investing at an early stage in the project.

From the developer's perspective obtaining a clear commitment from the community as soon as practicable whichever form of shared ownership model (if any) the community wishes to pursue is a key concern to minimise the risk of delay to the development of the project. In this regard early engagement with the community by the developer is recommended where possible.

(II) Funding

The source of funding will determine the nature and scope of the issues that the community will need to address. To the extent that the community seeks debt or grant finance from public sector sources it will need to ensure that it satisfies the relevant funding criteria and address any due diligence enquiries raised. Where the community seeks funding from a bank it will also need to satisfy the funding criteria and due diligence which may be more demanding and onerous compared to public sector funding. Bank finance will almost inevitably require the community to provide security for that finance the nature of which will depend on the bank's terms and what security (other than its shares in the SPV) the community will be able to provide to the bank.

Other potential sources of funding such as private equity and debt or equity based crowd funding may also be considered. In addition if the developer does not need the community's funds to finance the project it may be feasible to agree to capitalise any community benefit payments that the community may be due to receive from the project to finance the community's investment in the SPV.

(III) Shareholder protection

- (a) The level of control and protection that a community can realistically expect to receive will usually depend on the size of the community's investment as a proportion of the total number of shares issued by the SPV. The higher the percentage shareholding the greater the level of influence and rights that the community can expect to receive.

Bearing in mind that developers will usually expect to be the majority shareholder in the SPV and will therefore be entitled to exercise greater influence over the SPV's business affairs, the community will primarily be concerned to ensure that the joint venture agreement with the developer contains sufficient protection for the community as the minority shareholder. This is typically achieved by agreeing a list of what are usually referred to as "Reserved Matters" in relation to the SPV that require community approval before they can be implemented. For example a common Reserved Matter will preclude the sale of the business and assets of the SPV without the community's consent.

From the developer's perspective whilst recognising that the community will be entitled to a reasonable degree of protection, the developer will be concerned to ensure that the Reserved Matter protection agreed with the community is not so prescriptive as to undermine the developer's ability to build the project and run the business of the SPV.

- (b) Board representation. Another common issue is whether the community ought to be entitled to have the right to appoint a director to the SPV's board of directors and therefore have the ability to contribute to the decisions made by the SPV board as well as having visibility of the decisions made. Again the higher the percentage shareholding held by the community the stronger the case for the community having such a right.

The developer may or may not be receptive to the community have the right to appoint a director to the SPV board, particularly if the community investment is relatively small or if the SPV board is small and therefore gives the community appointed director a disproportionate level of influence relative to the community shareholding. One possible compromise is for the community to have the right to appoint a person who can attend SPV board meetings as an observer but without the voting rights that a director would have.

If the community has neither the right to appoint a director or an observer it will wish to ensure that it has sufficient access to financial and operational information to be able to monitor the SPV's performance. The developer may wish to limit the extent to which the community is given access to confidential information although the community would normally be obliged to keep any such information confidential under the terms of the joint venture agreement.

- (c) Drag and tag along rights. If the developer wishes to sell its shares in the SPV in future it may seek to include a "drag along" right in the joint venture agreement. A drag along right would essentially oblige the community to sell its shares in the SPV if the developer receives an offer for its shares that the developer wishes to accept. Some communities may resist agreeing to "drag along" rights particularly if they intend to hold their shares for the lifetime of the project.

Conversely if the community wants to have the flexibility to sell its shares in future it should seek to have a “tag along” right included in the joint venture agreement. Such a right applies where the developer wishes to accept an offer to sell its shares and requires the developer to obtain for the community the right for the community to sell its shares to the third party buyer on equivalent terms.

- (d) Pre-emption rights. Given that the relationship between the developer and the community will have evolved over a reasonable period of time both parties may be concerned to ensure that if one party wishes to sell their shares in the SPV they must first offer them to the other party at market value before selling to a third party with whom the remaining original joint venture party may not wish to deal with. In practice if the community only has a small shareholding and limited access to funds there may be little prospect of being able to afford to buy the developer's shareholding but nevertheless pre-emption right would give the community the flexibility to do so.

2 Shared revenue

With the shared revenue model rather than the community acquiring shares in the SPV it enters into an agreement to receive a share of the SPV's project revenues in return for a lump sum payment from the community. Obtaining the necessary funding to make the lump sum payment can be more challenging for a community compared to the other shared ownership models because of the lack of tangible security it can offer to a lender other than the shared revenue contract it has with the SPV (in contrast with the joint venture model the community can use its shares in the SPV as security and with the split ownership model it will have physical assets to offer in security).

Key issues

(I) Timing of investment

Similar issues apply here as to the joint venture model, although in our experience shared revenue arrangements are more likely to be entered into on or after financial close.

(II) Funding

As highlighted above financing a shared revenue venture through conventional bank finance can be challenging due to the lack of security that can be offered by the community compared to the other shared ownership models. Sources of public funding may still be available as well as private equity and crowd funding. In addition if the developer does not need the community's funds to finance the project it may be feasible to agree to defer payment and use the revenues received from the project to finance the community's payment to the developer. It may also be feasible to agree to capitalise any community benefit payments that the community may be due to receive from the project to finance the community's investment in the SPV.

(III) Calculation of SPV project revenues

Given that the community's revenue stream from the SPV is dependent on the SPV's revenues it is essential that the calculation of those revenues is clear and transparent. This is particularly so when the community's revenue stream is based on the SPV's net revenue after deduction of certain items of cost. In that case the community will be concerned to ensure that the deductible items are not open to any form of manipulation that reduces the payments due to the community and that calculations can be audited by the community to verify the sums paid.

For that reason a calculation based on the SPV's gross revenues is perhaps the most beneficial to the community as it avoids the sorts of argument that can arise over deductions made from gross revenue if the community's revenue stream is calculated based on the SPV's net revenue. From the developer's perspective a calculation based on the SPV's gross revenues creates the risk that the gross revenues do not reflect the profitability or otherwise of the SPV which could be adversely affected by fluctuations in overhead costs.

(IV) Information and audit

As indicated above the community should ensure that it has sufficient access to financial and operational information to be able to monitor the SPV's performance. The community should also consider seeking the right to audit the information provided. The developer may wish to limit the extent to which the community is given access to confidential information although the community would normally be obliged to keep any such information confidential under the terms of the shared revenue agreement.

3 Split ownership

The split ownership model involves the project being divided into two or more separate generating schemes or different parties owning different assets in the same project e.g. where the community acquires a single turbine on a windfarm or a number of PV panels in a larger array. In either case the community acquires physical assets and may or may not share common infrastructure and operating costs with the developer/operator of the project.

Key issues

(I) Timing of investment

Similar issues apply here as to the joint venture model, another key factor will be whether the community take operation responsibility for the construction of its part of the project or whether as is likely the developer constructs the full project with the community acquiring the relevant assets (turbines, PV panels etc) on commissioning of the project.

(II) Funding

As above similar issues apply here as to the joint venture model, indeed the financing of the acquisition of physical assets means that a wider source of funding options such as asset finance may be available to the community

(III) Shared infrastructure/operating costs

The issues that may arise regarding shared costs will depend on the particular circumstances of each project but whatever costs are to be shared it will be important to make sure that the terms upon which the shared costs arrangements are to operate are clear, transparent and auditable to minimise the risk of later dispute.

(IV) Liability and warranty claims

Where it acquires the commissioned assets from the developer (rather than being responsible for the acquisition and construction of its own assets) the developer and the community will need to agree the extent of the developer's potential liability to the community for any defects in the acquired asset. The developer will wish to limit its liability particularly where it relies on third party contractors and suppliers in which case the community will need to ensure that it can acquire the benefit of any warranties granted in favour of the developer as well as the benefit of any claims the developer may have in relation to the construction of the project.