# Community Shared Ownership Market Engagement Report – Local Energy Scotland

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# 1. Executive summary

1.1 Shared ownership of renewable energy projects forms a key role in the Scottish Government's Energy Strategy, seeking to develop sustainable local energy projects that will have a lasting benefit to surrounding community's socioeconomic environment. Local Energy Scotland ("LES") has managed the Scottish Governments Community and Renewable Energy Scheme ("CARES") since 2013, supporting communities to engage with, participate in, and benefit from renewable energy development through shared ownership schemes. LES has appointed QMPF to complete a market engagement exercise with developers and community group funders with experience in shared ownership projects to understand the different commercial models used, identify any common barriers or challenges which shared ownership models face and any recommendations that could be made to improve adoption of shared ownership projects and accelerate progress towards the Scottish Government's target of 2GW of community and locally owned energy by 2030.

1.2 In total twenty-three market participants were contacted, of which seventeen engaged in this process which included eight developers, five funders and four community groups and one wider market participants. Of the developers engaged, we aimed to get a spectrum of small local operators to large multinational utility scale developers at varying stages of the shared ownership process favouring differing commercial models. Funders were engaged such that as many funding options available to communities were covered such as crowdfunding, debt funding, equity investors and potential government funding options. Funders included boutique lenders to community groups, crowdfunding platforms, merchant banks and high street lenders, although some banks approached declined to participate. To add context to discussions with developers and funders several other stakeholders were engaged including community groups and a Scottish Government agency.

1.3 The sample group was selected to be representative of the wider shared ownership market in Scotland, although it is important to state that not every view may have been covered. Parameters used to create the sample group included developer size (i.e. utility scale or SME), preferred operating model, funding type etc. It should be noted that this report does not cover community-owned project models such as split-ownership or sole-owned as these models are not as prevalent in the market.

1.4 From the developers that were engaged, the two most prominent shared ownership commercial models being employed by low-carbon developers in Scotland, excluding community-owned projects, were joint venture ("JV") and shared revenue models. Although wholly owned community projects are still occurring in the market, the focus of this report is on community shared ownership. A JV model is where the community group acquire shares in the project, typically as a minority shareholder. A shared revenue model is where the community group purchases a contracted revenue stream in an upfront investment. It is evident from the feedback that there is unlikely to be a consistent, single model or approach to shared ownership in the market, which was an objective that LES were looking to solve, however there are several common structural themes which are discussed in more detail below.

## DEVELOPERS

1.5 All the developers we spoke to either already had existing shared ownership offers out to communities or had planning applications which indicated an intention to include an offer for shared ownership. The most common and prominent benefit that developers stated to having a community involved in shared ownership was generating local community buy-in, involvement and support to the project. This was strategically important for some developers, although others mentioned the implied benefit to

achieving positive planning decisions, both at initial project development and future potential expansions or repowering. While this was accepted as a benefit, they recognised it was difficult to quantify. Some of the developers also felt obliged to offer community shared ownership as it was a condition included as part of their bid to secure land lease agreements on some sites. Developers highlighted that more transparency is required for Scottish Government policies around shared ownership. They are looking for more explicit guidelines/legislation regarding shared ownership, particularly its bearing on planning application decisions.

1.6 With that said, developers highlighted that community involvement via shared ownership brings additional project concerns such as additional cost (resource, time, and money), decreased developer equity, minority shareholder rights and a perception of associated drag on asset valuations, minority investor relationship management and potential reputation risk via community group loss of investment in downside scenarios. Conversely, there may be opportunities for developers to offset some of these costs for example through potential business rates relief.

1.7 Dependant on project size, developers typically offered less than a 10% ownership stake to the community, with some offering up to 49%, however stating that a lower stake is preferable and more realistic. Developers' general preference is for projects to be priced on a discounted cash flow basis at zero cost to the developer (i.e., at developer funding costs), although many developers had not priced offers and we had limited sight of actual developer offers. Investment tenors were typically for the asset life (30-years plus). However, some offers, more common in shared revenue models, were for a 10-25-year duration. This is contrary to Scottish Government Good Practice Principles for Shared Ownership of Onshore Renewables Energy Developments[1] guidance which states the offer should be made for the lifetime of the project. It was clear from developers that most would not support community groups in seeking funding, although a few are willing to consider providing loans to communities on a case-by-case basis. It was also evident from some conversations that there was limited consideration made by some developers to the community's ability to raise funds and the cost of those funds when offers were structured or priced.

1.8 Broadly, developers are prepared to offer community groups the minimum level of minority shareholder rights required by law and were less supportive of including board representation and/or voting rights, which might be beneficial to support interest and pricing from community group's funders. The majority were open to the principle of entering direct agreements with community's funders should one be required, although they hadn't necessarily worked through the detail of this internally or with their own funders.

1.9 The larger scale developers engaged with in the process typically operated a shared revenue model, stating one or more of: limitations imposed by their commercial structure (i.e., projects are on balance sheet, not held within Project SPVs), potential asset valuation drags, and the costs associated with administering minority stakes as the main factors. Smaller developers were generally less restricted by their commercial model and could tailor their offering to suit the community groups preferences. [] and

[1] From the Scottish Government Good Practice Principles for Shared Ownership of Onshore Renewables Energy Developments report: https://www.gov.scot/publications/scottish-government-good-practice-principles-shared-ownership-onshore-renewable-energy-developments/pages/2/

[] stood out as offering potentially the most fundable commercial model, offering a 1% gifted equity share should the community group decide to invest the remaining amount.

1.10 Some developers offered the community group the option to capitalise their future community benefits to support their shared ownership offer. In practice, the ‘community’ receiving the community benefit may not be the same group that are going to take up a shared ownership offer, reducing the applicability of this option in such cases. Some developers are considering offering minimum return guarantees to support funding security, also this was not a common theme but would help support community’s ability to secure external funding. Although not discussed by developers, other potential options such as business rates relief could also be passed on to the communities to support external funding.

1.11 A key concern raised by developers was the community group’s ability to manage their investment, both at initial investment and throughout the project life. Developers wanted to minimise their liabilities to reputational damage which they though may be a risk if a community group breaching its financial covenants or did not recover its initial investment in the project.

1.12 Developers indicated a preference to engage with, a single community entity when making shared ownership negotiations and that entity must also be the same entity that makes the investment.

## FUNDERS

1.13 Community groups generally have limited to no cash available to make a shared ownership investment when approached by a developer so they will require additional funding to make the investment. For a shared ownership investment to be commercially viable for the community, the community’s returns on investment must exceed the community group’s cost of funding plus a sufficient margin for the community that recognises its investment risk. Funding costs are typically priced at the market funding rate which will be the risk-free rate (Bank of England base interest or swap rate) plus a margin for the funder/investor that recognises their risks of lending/investing in the project. If developers are wanting community ownership in the project, they must be cognisant of these factors when pricing their offers. In cases where these conditions do not align for the community group, shared ownership may not be feasible.

1.14 The funding market for community groups in the UK is small and limited to bespoke funders. The recent withdrawal of the Scottish Government’s Energy Investment Fund (“EIF”), which was historically an active funder in community shared ownership projects, has reduced the funding options available to communities. In some cases, the EIF team also took an active involvement in the structuring of projects, which provided extra support to communities.

1.15 There has not yet been a material interest from traditional banks, mainstream lenders or an EIF replacement to fill this gap. From discussions with larger lenders, it was clear that shared ownership projects have not previously met their funding appetite range but may do so on some of the larger scale projects in the pipeline. The bespoke funders in the market were generally flexible in what type of funding they could offer which included debt, equity, mezzanine debt and bridge loans to suit community groups requirements. Furthermore, funders noted that they can offer early repayment options to communities, allowing them to raise additional funds through crowdfunding or other means to service the outstanding loan early.

1.16 Funders stated that they required security over the community's rights to the shared ownership revenue/profit stream, likely over the shared revenue agreement and/or the community's company which holds the investment in the project. Debt funders would require the community's investment to have protections in place to ensure the community's investment was preserved or compensated under a sale, or termination, scenario of the project (e.g., if the developer/owner decided to sell its stake or terminate a revenue share agreement). Generally, funders preferred the JV model as the community should be entitled to minority shareholder protections, returns were expected to be higher so could cover funding costs and the equity investment structure was more familiar to the funders. Some funders stated that they could also fund a shared revenue model but on the basis that the same/comparable security provisions were attached.

1.17 The current market participants typically offer funding at a cost bespoke to the project and funding risk profile. This funding is typically at a cost above that of traditional bank lending which can limit the application to marginal projects where the community group return is lower, although this may partly reflect their ability to accept less security or contractual requirements and hence more risk in their loan offering. Furthermore, lack of competition in the market provides little incentive to offer lower cost rates.

## GENERAL POINTS

1.18 Funders and developers had a general view that communities' shared ownership investment is better suited to be done at commercial operations date ("COD"), highlighting that the risk profile of an investment at financial investment decision ("FID") may not be suitable for the community groups and carried an associated risk to the developer and funder (e.g. delays or cost overruns could require communities to raise additional funds which may impact their initial investment return). Furthermore, investing at COD gave the communities more time to seek advice and raise funds, which was noted as being challenging in advance of FID. Some developers noted they could not accept a risk of project's FID, and start of construction, being delayed due to a delay from the community's fund-raising process.

1.19 A common challenge with shared ownership projects is the community group's experience, resources and expertise, which can vary widely between communities. Although CARES can support communities with advisors and general support during the offer negotiation, this aspect appeared to be a particular concern for developers who highlighted that significant continued resource is required to ensure that the community is informed and knowledgeable about the investment/partnership across the duration of the project. It was also noted by funders that they needed to have a community representative that understood the risks associated and had adequate stewardship to maintain repayments.

1.20 There is not a "one size fits all" approach that can be adopted in the shared ownership market, various limitations imposed by developers, funders and community groups restrict the applicability of a single model to suit all parties. This means there are likely to be two different ongoing investment models: the JV model and the Shared Revenue model, as described in 2.12 of this report.

1.21 With that said, there is a desire from developers and funders for a standardised model(s) or framework which can be used as a basis for shared ownership offer structures. This could then be refined to suit the individual specifics of the developer, funder, or community group. The feedback from developers was that each developer is having to create a model from first principles and adapt the model as the project and discussions with communities progress, which has a cost (resource, time), is harder to get agreement on internally as they cannot point to a market benchmark and a risk factor associated with

the offer being successful (e.g. the newly developed offer may not work for the community or its funders). If there was a framework this would streamline this process and help address these issues. Similar feedback was received from funders of the community groups.

1.22 Based on discussions with developers, funders, and community groups some examples were raised of requirements that would be needed to enable the communities to be able to raise funds to invest in the projects. Table 1 below, and further expanded in section 4, gives a summary of the specific requirements that community groups are likely to require to be able to raise finance to support a shared ownership investment in each of the commercial models. A more detailed table is attached in Appendix 4. Each project would need to be assessed on its own merits to find appropriate structure and protections that would allow funding to be raised but also be acceptable for the developer and community.

*Table 1: Structural features of JV and shared revenue operating models.*

| | Joint Venture | Shared Revenue |
|---|---|---|
| Minimum requirements | •Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Access to financial information and project decisions that may impact shareholders return<br>• Protections in the event of a sale<br>• Minority shareholder rights | •Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Access to financial information and project decisions that may impact shared revenue investors return<br>• Protections in the event of a sale or termination<br>• Equivalent protection to minority shareholder rights written into contract |
| Likely additional minimum requirements where community needs external funding | • Security over the Community's Project SPV shares<br>• Step-in rights to act in place of Community | • Security over contracted revenue agreement<br>• Step-in rights to act in place of Community |
| Additional aspects that could provide communities with access to more funding options at better rates | • Project SPV board representation<br>• Security over community benefit income<br>• Minimum return guarantee/loan floor note<br>• Structural protections included in operating contracts (e.g. LDs or performance guarantees in O&M contracts) | • Project SPV board representation<br>• Security over community benefit income<br>• Minimum return guarantee/loan floor note<br>• Structural protections included in operating contracts (e.g. LDs or performance guarantees in O&M contracts) |

1.23 In a shared revenue model arrangement, community group funders are likely to require equitable rights to a minority equity shareholder in the project to provide funding. Developers and community groups will need to be aware of this when entering a shared ownership arrangement where external community debt funding is required, unless other ways are found to meet funders' requirements.

1.24 It should be recognised that shared ownership requires a willing developer and community group in order to get the project to development. Developers should also recognise that having the community involved through shared ownership will incur some cost (time, resource, and money) and may not be cost neutral, although there may be business rates relief which may be available to projects with

community shared ownership which can be offset against this. The intangible value of having community shared ownership, if recognised, may help developers generate internal support, particularly where the developer is considering other development opportunities in the area or repowering.

1.25 All investment models discussed were on the basis that the community will form an SPV to make the investment into the project, whether it is a shared revenue or JV investment opportunity. It is that Community SPV which would then secure the funds to make the investment, either from the community itself, via the project or from external sources.

1.26 The diagram below outlines the high-level security requirements of a community funder, and other contributing factors that may improve the funding terms of the agreement for the community group.

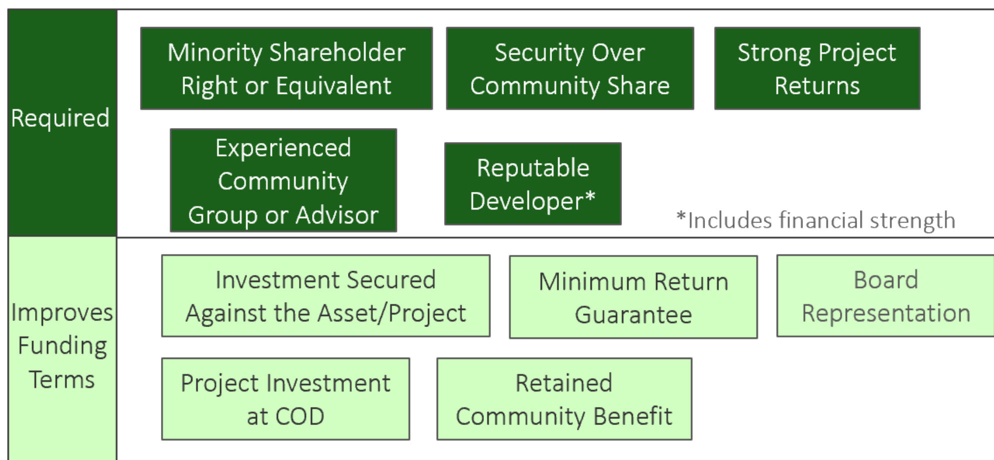


*Figure 1: General community funding requirements.*

1.27 Where some of these terms outlined in Figure 1 are not possible, this could increase the funding cost to the community in the first instance, reflecting increased risk to the funder and/or reduce the amount of capital the lender is willing to provide (reducing the funder's exposure to the investment). In some cases, the limitations on the project may restrict the lender from being able to fund a community's stake in a project.

1.28 There may be situations where shared ownership is not commercially viable, for example where project economics make it difficult for the community to raise funding.

## RECOMEDATIONS

1.29 There was broadly a consensus amongst developers, funders and communities that a standardised approach to a shared ownership investment model (or models to the extent some flexibility is required in the investment structure, for example a standardised joint venture model and standardised shared revenue model) would help support more projects deliver community shared ownership investments going forward.

1.30 This leads to a number of recommendations to help achieve this:

1. Produce a draft of example shareholder agreement for a joint venture investment and shared revenue agreement for a shared revenue investment and guidelines on community investment

structure which can be shared publicly. This should draw on the outcomes from this report and take consideration of interests from all stakeholders (developers/project owners, communities, and funders (community funders and project funders).

2. When a framework or example funding agreement model has been drafted, it should be tested, ideally using live shared ownership offer opportunities, feeding back improvements to enhance the framework and evidencing proof of concept and commercial viability. Support in the form of a willing community lender and any contribution to costs (to the extent not already available via LES) may be helpful to enable the initial investments to occur.
3. Clearer guidance on the Scottish Government Good Practice Principles for Shared Ownership of Onshore Renewable Energy Developments would be helpful in order to remove any ambiguity around the approach to investment and project valuation. For example, several developers had different interpretations of the guidance, particularly with regards to the statement "shared ownership in a renewable energy project should not reduce the overall economic viability of the project". Clearer guidance in this respect would remove any ambiguity of the guidance and standardised the valuation approach and may help developers and communities better understand each other's positions from the outset.
4. Increase awareness of the benefits of shared ownership and help to quantify these to include within the valuation approach. For example, giving projects access to business rates relief. The clearest benefit noted by developers of including shared ownership offers was to improve community engagement and support in projects (as communities that are invested in the project are aligned on the successful development and operation) which they ultimately viewed as having an implied positive impact during planning process. Any stronger incentives, for example a direct benefit of community investment in the planning process, that can be made to entice developers to make commercially viable (for communities and developers) shared ownership offers will significantly improve the occurrence of shared ownership investments.
5. Specialist advice (tax and legal) could be sought on whether particular community investment structures could ensure the community is able to full realise any reliefs which may be available to it. For example, if the community investment vehicle is registered as a charitable body (or is wholly owned by one) then it may receive relief on corporation tax, however this may not be able to be recognised within some investment structures.
6. There seemed to be a lack of understanding of shared ownership both from funders not currently involved in the sector and from developers who have not yet taken projects through with a shared ownership offer attached. This is potentially limiting wider market interest in the shared ownership opportunities and also may be steering potential stakeholders to favour investment models they are more familiar with (e.g., funders typically noted a preference for JV models, which may in part due to a lack of understanding in potential security provided under a shared revenue agreement).

# 2. Introduction and methodology

2.1 The Scottish Government's Energy Strategy outlined its ambition to see communities benefit from the development of onshore renewables in their local area, with the aim to reinforce positive associations with renewable energy in local communities whilst also providing long-term socioeconomic benefits to them.

2.2 QMPF has been appointed by Local Energy Scotland ("LES"), which delivers the Scottish Government's Community and Renewable Energy Scheme ("CARES") to complete a market engagement exercise with renewable energy developers, community groups, and community group funders with relevant experience in shared ownership projects. The objective of the exercise is to better understand each stakeholder's requirements to help structure shared ownership opportunities in a way which enables communities to seek external finance to fund their investment requirement.

2.3 This report will summarise findings from market engagement discussions with developers and community group funders to understand:

- Developers'/funders' experience with shared ownership projects.
- Typical offers made to community groups for shared ownership investment.
- Different models used by developers on shared ownership projects and their impact on community groups.
- Engagement process of developers with communities and subsequently communities with funders.
- Funding options available to community groups and how this impacts the community group's ability to invest.
- Security available to community groups in a shared ownership project.
- Challenges associated with the shared ownership projects and suggestions to improve the process to increase stakeholder engagement.

## BACKGROUND

2.4 Shared ownership of renewable projects in Scotland started in the early 2000's with the development of the 2003 Land Reform Act which empowered communities to regain ownership of local land. At the same time, community groups were encouraged by the Scottish Government to participate in the Renewable Obligation Certificates ("ROCs") subsidy scheme, which was a market-based incentive for projects commissioned between 2003 and 2016 and which promoted generation of electricity from renewable energy sources over more traditional, carbon intensive alternatives.

2.5 Early community ownership projects were predominantly community-owned models whereby the community would own a single asset or group of assets either through self-development or through a split-ownership arrangement. Following the reduction in ROCs support and as projects scaled, community-owned models became less prevalent, and the shared ownership model became the typical commercial model adopted by developers looking to engage communities on low-carbon energy projects.

2.6 In 2014 (later refreshed in 2019), the Scottish Government published national guidance on the good practice principles for 'Community Benefits from Onshore Renewable Energy Developments'[2], where developers were encouraged to contribute at least £5,000/MW, of installed capacity to local communities which is index linked across the life of the project. The objective of the good practice guidance was to provide a passive monetary benefit to community groups to reinvest into local initiatives. Since introduction, many developers have provided and continue to provide community benefits in line with Scottish Government guidance, distributing c. £25m in community benefit funds between in 2022.

2.7 In May 2019, following consultations with steering groups from industry and communities, the Scottish Government refreshed their 2014 guidance on good practice for 'Shared Ownership of Onshore Renewable Energy Developments[3], which involves a community group as a financial partner over the lifetime of a renewable energy project. Unlike community benefits, shared ownership offers communities a stake in long-term performance of the project, which helps to align incentives of developers and communities and gives communities a vested interest in the success of the project.

2.8 The Scottish Government has ambitions for community shared ownership to become standard practice across all renewable energy projects in Scotland going forward as it sets out its vision of creating a competitive and flourishing national energy sector that will deliver a legacy of benefits to communities while delivering on net-zero targets. The Scottish Government has recently amended their onshore wind policy statement such that shared ownership should now be considered, explored, and offered on all new renewable energy projects in Scotland, including extensions and repowering's with the target of reaching 2GW of community owned capacity by 2030. The diagram below outlines the Scottish Government's rationale for endorsing community shared ownership.

*Figure 2: Scottish Government community shared ownership good practice principles rationale diagram.*

[2] From the Scottish Government Community benefits from onshore renewable energy developments: https://www.gov.scot/publications/scottish-government-good-practice-principles-community-benefits-onshore-renewable-energy-developments/

[3] From the Scottish Government Good Practice Principles for Shared Ownership of Onshore Renewables Energy Developments report: https://www.gov.scot/publications/scottish-government-good-practice-principles-shared-ownership-onshore-renewable-energy-developments/pages/2/

2.9 Scottish Government guidance states that the host 'community' should be defined at the beginning of a project, it could incorporate one or more community councils and/or community organisations in the local area surrounding the development. This is commonly known as the 'area of benefit' and is defined through consultation with local communities to identify a community group(s) that will be responsible for receiving and distributing the community benefit funds received. The guidance states that the 'community' can extend beyond the area of benefit as required to attract wider investment appetite for shared ownership investment. However, communities situated close to the site should be offered the opportunity to invest first.

## COMMUNITY GROUPS

2.10 When community groups are approached by a developer offering shared ownership on a project the community group may not be in an immediate position structurally and/or financially to take up the offer which could require a material cash investment. Consequently, it may have to raise funding to support its investment and create a funding vehicle through which to invest in the project (see Appendix 2 for different community funding options). Since the locations of wind farms are often remote, the community population within the area of benefit may be small and, as such, struggle to assemble a suitably experienced and organised community group to manage the community's investment.

2.11 Where community groups can assemble a community entity that is interested in investing in an opportunity, they may need to seek advice in relation to the offer received by the developer and funding routes available to them. This could incur a cost for the community prior to receiving investment. LES can provide impartial advice and through CARES where communities can apply for funding to support appointing advisors.

## SHARED OWNERSHIP MODELS

2.12 Shared ownership commercial models for renewable energy projects currently in place or being considered for use by developers fall under two overarching models, a joint venture equity investment ("JV") or shared revenue agreement ("shared revenue"). Historically there have been projects that utilised a split ownership arrangement, where a community acquired a specific part of the project (e.g. a single wind turbine in the wind farm). However, based on discussions with the market, this model is no longer favoured by developers, communities or funders. This report therefore focuses on the JV and shared revenue models and does not consider the split ownership model further.

### JV MODEL

2.13 The structure involves the developer, or project owner, creating a company whose sole purpose is to own and operate the renewable energy project. That company is usually referred to as a special purpose vehicle ("SPV"), which would often be incorporated as a limited company with shares issued (although other structures such as a limited liability partnership ("LLP") may also be utilised). The community group is given an opportunity to acquire, for an upfront sum of money, some of the shares in the SPV. This would usually be a minority stake, typically less than 10% of the total shares in the SPV, although in some instances could be up to 49%. The amount the community would be required to pay for the shares will be dependent on the developer and project specifics and is discussed further below at section 3.27.

2.14 The community would then be treated in the same manner as any other minority shareholder, with an option or requirement to provide shareholder capital if and when required and be entitled to equity distribution of profits throughout the life of the project. The community's investment would be

protected by standard minority shareholder rights. The community may seek additional protection via a separate shareholders' agreement such as timely distribution of financial information (e.g., quarterly management accounts) and potentially board representation (voting or observational) although this may not necessarily be offered by all developers.

2.15 The community group would need its own company, or legal entity, (the "Community SPV") from which it would acquire and hold shares in the Project SPV ("Project SPV"). This may or may not be the same entity which receives the community benefit payments from the project. Any external funding which the community group raises to fund its ownership stake in the project (the "Community Funder") would reside in this Community SPV.

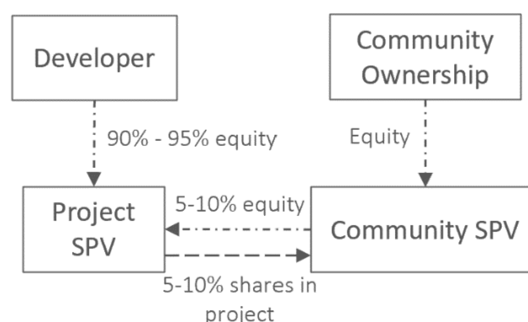


*Figure 3: Basic JV shared ownership model.*

2.16 The community would need access to sufficient funds to acquire the equity in the Project SPV. The Community SPV can be funded by equity, debt, or a mixture of both dependant on the community's available funds and availability of third-party lenders. Where debt funding is used, the community group will still own the Community SPV but will make debt repayments to its funder before taking the remaining profits as its equity return.

## SHARED REVENUE

2.17 A shared revenue model is where a community group buys the right to a future revenue stream from a project. This revenue stream is usually calculated as a percentage of "revenue", although this is not necessarily gross revenue (i.e., revenue before costs and deductions), with the option for the shared revenue figure to be defined and calculated at any point in the cash waterfall from gross revenue down to net profit (i.e., after all costs and expenses are deducted). The definition of the revenue stream will be dependent on what the developer is willing to offer and agree to, so may change from project to project.

2.18 In a shared revenue model, the developer retains all the equity in the project and has a separate contracted revenue share agreement between the Project SPV and the Community SPV to distribute the community's revenue share. In a similar way to the equity model, it is likely the community group will need to pay an upfront amount to obtain the shared revenue agreement, and as such may need to raise capital to do so. In effect, by entering into such an investment, the community is purchasing a future revenue stream from the project, rather than taking an ownership stake.

2.19 In a shared revenue model, the community group will not have minority shareholder protections as standard and would usually be considered passive investor in the project.

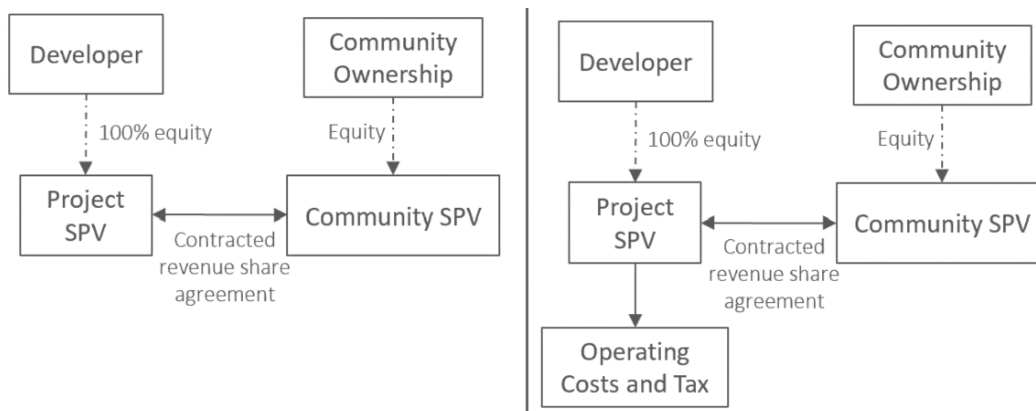


*Figure 4: Basic gross revenue share model (left) and net shared revenue model (right).*

## MARKET ENGAGEMENT METHODOLOGY

2.20 We started the market engagement process with a review of active developers, community group funders and other relevant stakeholders in the shared ownership market. We also looked to get input from community groups that have experience in shared ownership investments. In collaboration with LES we created a target list of stakeholders which resulted in input from eight developers, five funders and five wider market participants which included four community groups and a government agency.

2.21 The target developer list includes a range of business sizes and structure to understand the various approaches to shared ownership and identify any salient themes. The funders in the target list offered products that cover a range of potential funding options available to communities in shared ownership projects including community crowdfunding, debt funding and equity funding. In addition to funders and developers, other stakeholders such as community groups that have been through the shared ownership process and government entities to gain a wider understanding of the market and inform subsequent discussions.

# 3. Key feedback from market engagement

3.1 Based on the findings from the market engagement exercise with community group funders, developers, and wider market participants, several salient themes emerged. Themes that are applicable to both shared revenue and JV models are first explored in the 'General' section before themes specific to each model are considered in the respective shared revenue and JV specific sections. A list of terminology used throughout the report has been included in 5.11 for reference throughout. Summary conclusions and recommendations based on the feedback from stakeholders are outlined in section 5.

## GENERAL

3.2 Table 2 below summarises the overarching key themes derived from the market engagement exercise. Further details on each point are given in the subsequent section.

*Table 2: Overview of key themes derived from the market engagement exercise.*

| | Developer Feedback | Funder Feedback | Community Feedback |
|---|---|---|---|
| Commercial Model | • Mixed preference between JV and shared revenue models<br>• Most developers think shared revenue is simpler and more cost effective to implement<br>• Some cannot offer JV due to their own investment structures | • Overarching preference for JV model<br>• Open to considering shared revenue | • Broad preference for JV model<br>• Some open to shared revenue |
| Business Case | • See benefit to community buy-in during planning for existing site, extensions and repowering – all noted this is difficult to quantify<br>• Recognise there is a cost (time, resource and money) to implementing shared ownership investment<br>• Most aim to achieve a cost neutral impact to their investment, in line with SG principles<br>• Some are able to offer investment at cost, or including a gifted stake<br>• Some developers are conscious they do not want to adversely impact potential future sale of the project | • Pricing of loans reflect the risk associated with the community's investment stake (e.g. minority share, available security)<br>• Must be of sufficient scale to justify lending | • Community groups do not typically have access to sufficient funds and must raise external funds to make an investment<br>• The return on investment in the shared ownership opportunity must be greater than the cost of the community's funding for the investment to make commercial sense |

| | Developer Feedback | Funder Feedback | Community Feedback |
|---|---|---|---|
| Security / Rights | • Accept minority shareholder rights on JV model, open to consider on shared revenue<br>• Preference for limited/no voting rights on project decisions or board representation in Project SPV<br>• Open to step-in rights and direct agreements with community group funders in the community investment vehicle | • Requirement for minority shareholder protections under both models<br>• Preferred to have voting rights/board representation option in Project SPV<br>• Preference for additional securities over shares, step-in rights and direct agreements in the community investment vehicle | • Preference for minority shareholder protections under both models |
| Valuation | • Variety of valuation methods used, capital cost, valuation at a market rate (if the project was to be sold through a competitive sale process) or using a discounted cash flow at a rate somewhere in between. | • No preference, focussed on ability to repay debt in future | • Preference for most attractive valuation method for community group (i.e., lowest upfront cost) |
| Investment Stage | • Slight preference for COD investment<br>• Some cannot offer FID investment | • Overarching preference for COD investment although some can provide FID | • Preference for COD investment given timelines and risk<br>• Some open to consider FID |
| Ownership Stake | • Preference for an ownership offering of 5-10%<br>• Some can offer more than this | • Prefer a larger stake to achieve minimum investment amounts | • Generally open to the maximum shared investment offering if it can secure funding for |
| Investment Tenor | • Most for the duration of project c. 30 years<br>• Some offers for less than this, contrary to Good Practice Principles guidance, typically on shared revenue models | • Broadly flexible in lending tenor | • Preference for project duration |
| Monetised community benefits | • Most offered this option<br>• Some wanted to keep community benefits separate if they see these mechanisms as being separate | • Some funders could invest alongside monetised community benefits<br>• Preference to have security over community benefit income if available | • Preference to keep community benefit separate<br>• Some considered as a back-up option after failing to raise other capital, although must be at a commercially viable value |
| Other | • Preference to deal with one community entity (which may include multiple community groups)<br>• Preference for communities to have representatives, or advisors, knowledgeable of industry and similar transactions during investment decision and throughout investment life. | • Community needs to have advisors on board (if not of sufficient capability within community group). | • Generally, communities feedback that insufficient information has been provided by developers to allow communities to properly assess investment opportunities.<br>• Noted that expertise and decision-making capacity can vary significantly between different community groups so sometimes difficult to progress opportunities. |

3.3 Developers' typical community shared ownership offering ranges between 5%-20% of the equity or revenue generated by a project. The size of the investment stake is dependent on the size of the project. Some developers stated that they can offer shares in the project up to 49% but highlighted their preference is a smaller investment size in the range noted above (and some of those only offered a larger share due to specific requirements included in their bids to secure site leases from land owners).

3.4 In general, investment tenors offered to community groups were for the life of the project which was estimated to be c. 30 years plus. Some developers, predominantly operating shared revenue models, had a shorter tenor offering, ranging from 5 to 25-years which does not align with the Scottish Government Good Practice Principles.

3.5 Based on feedback from the developers that were engaged in this process, there are several approaches to valuation being considered for shared ownership offers. The first is an offer value at the developers' cost of development (e.g. a proportional split of actual spend to date), this option is likely to be favourable and commercially viable for the community as it all of the upside benefit from de-risking the project through to operations is for the community (i.e., the rate of return on the communities investment will be higher than the valuation approaches discussed next).

3.6 Most of the developers engaged valued the community's investment on a discounted cash flow basis, where the discount rate applied to the valuation is up to the discretion of the developer. Some developers noted they were able to offer to value the shared ownership investment at a favourable discount rate, which would be reflective of a lower investment value that the project share may command if sold to the market. A small number of developers were offering the community a share of the project valued at market rate, which is intended to represent the highest value the developer may be able to achieve if it sold the investment commercially. They can make the communities investment case challenging as there may be very little (or no) difference between the rate of return used in valuing the community's investment when compared to the community's cost of funds (i.e. the community would be unlikely to make any profit from the investment so there would be no commercial reason for investing).

3.7 In two instances developer was able to offer the community a gifted stake up to 1% of the project if they took up the investment offer – this was not common and may not be achievable as a market standard but is the most favourable position discussed when considering from a community perspective and its ability to raise funds for the investment on a commercial basis.

3.8 For community groups, their preference was for the developer to recognise the value in community shared ownership and offer either a gifted share or a favourable valuation which would support funding, provide a better community return or even make shared ownership feasible (e.g. at cost or below market rate). Communities stated that after their funding costs, investing at market rates would most likely be uneconomical, stating that at cost offerings can work for strong performing projects, provided funding costs are less than project returns.

3.9 Although funders were not in a position to influence the community's offer, they highlighted that a gifted share would be advantageous to their funding position as the funder could look for security over this gifted share. Furthermore, a larger difference between the funding cost and project returns (i.e., community return) will give the funder more confidence that the community group will have sufficient resources to maintain repayments, even during underperforming periods.

3.10 Funders highlighted a preference to fund community groups that require in excess £1m and for larger banks more accustomed to funding the projects themselves the ticket size would need to be in excess of £10m. The larger funders had no experience in funding communities' stakes in shared ownership investments and the pool of lenders that have been active to date has been small. There could be an opportunity for a lender or government entity to fund several projects to provide proof of concept, while using a relatively standardised loan offer and associated community investment structure, which may increase activity from the wider funding market in the sector. With that said, based on our discussions a range of lending options are available including debt, equity, mezzanine debt and a debt/equity blend. Some lenders also stated that they could offer early repayment options to community groups who may raise additional funding through alternative means such as crowdfunding or fundraising activities. Although not commonplace, the developer may also provide funding to the community to support their investment on a case-by-case basis.

3.11 Developers were sensitive to the fact that they did not want to have a situation where a community group failed to service their debts due to operational performance, stating that the reputational repercussions for their business could be significant in such a situation.

3.12 Several developers were open to offering communities the option to monetise future community benefit payments on a discounted cash flow basis in a lump sum payment to fund a shared ownership offer. Conversely, some developers outrightly opposed offering such an arrangement, seeing community benefits and shared ownership as distinct offerings that should not be interchangeable. Based on feedback from some developers, community groups did not look favourably on this option as they view it as exchanging a guaranteed income for a riskier variable return, however in some cases where the discount rate is favourable to community this could be an attractive funding option. Furthermore, the community group receiving community benefits could differ from the group looking to make a shared ownership investment, in such case each group entitled to community benefits must agree to use the proceeds of the community benefits towards the investment. Although developers stated that it is possible for a subgroup within a larger community group to vote to roll up their 'share' of the community benefit fund, they said it would be too difficult to manage.

## ENGAGEMENT STAGE

3.13 Developers prefer to engage with the community at the early project stages during planning application pre-FID to introduce themselves and begin to build a rapport with the community. The objective of these sessions is to communicate the benefits of the project, identify key requirements from the community and gain internal support for the project. After the project is suitably developed which is typically prior to submitting a planning application, the developer will typically hold information sessions which will detail an indicative shared ownership offer, providing an MOU with more details of the opportunity for the community group to consider. Communities agreed that early engagement is beneficial, and some noted that some historic investment offers had been made too late or lacked sufficient information for the community to be able to invest and then enough time to secure funding.

3.14 All developers stated they preferred community investment at COD, stating that the timelines were more realistic for community groups to organise, seek advice, and raise funding. Developers highlighted that it was easier to galvanise local support during construction when the community can see what they were investing in. Investing at COD reduces the community's exposure to construction risk which if exposed to could impact their ability to service their debts in the case of construction delays. Several developers highlighted that they did not want to risk the reputational repercussions to the developer of

a community organisation defaulting on its debts after making an FID investment where the default was caused by delays in construction, cost overruns or similar.

3.15 In general funders agreed with developers, stating that they would feel more comfortable investing at COD when construction risk has been retired. Several funders did highlight that they could fund an FID investment although stating that their funding costs would be reflective of the increased risk.

## CHALLENGES

3.16 Market engagement highlighted that community group's understanding and experience was a major challenge in shared ownership projects as it can vary widely between different groups. Developers stressed that in some projects the additional time and cost required to educate community groups on processes impacted the efficiency of delivering the project. Funders also expressed concerns about lending to a community group, who are not sophisticated investors and may not fully understand the risks and commitments required from their investment.

3.17 Based on conversations with developers, it was apparent that some developers had not fully considered the implications of their offer on the community groups. For example:

- The discount rate applied by a developer when valuing the community's investment often does not consider the community's return after funding costs.
- Details of the ownership offer from the developer often had not been fully considered until financial close/project consent.
- Developers often do not consider the additional costs incurred by the community group over and above the initial investment which could include upfront advisory support (although can be supported by CARES), investment entity set-up and management, and additional resource.

3.18 For communities' funders to feel comfortable they noted that they would require as a minimum security over and step-in rights or similar security measures over the Community SPV. Communities and developers were generally comfortable with this, and developers acknowledged Community funders may need to step into a community's role during downside scenarios and were open to direct agreements to this effect if required (e.g., under shared revenue contracts). Community funders would seek for community's investments to include minority shareholder rights, whether using a JV or shared revenue model, including restrictions on share dilution, access to financial information and protections if the Project SPV is sold. Any additional rights or security provision over and above this could give communities access to a wider funding pool and potentially cheaper cost of funding. Developers highlighted that they would by reluctant to offer additional rights to community groups, particularly in shared revenue structured models.

3.19 An important point raised by developers was the ongoing support required to maintain the competence of the community representative(s) across the shared ownership agreement which could be 30 years plus. In that time, representatives in the community group could change several times as people move from the area. Therefore, there will be an ongoing requirement from the developer to retrain community group representatives which will have associate time and cost implications. This will also impact community group funders who will need to verify the stewardship of replaced representatives to ensure they understand their responsibilities in manging the community treasury such that they meet funding repayments.

## IMPROVEMENT SUGGESTIONS FROM MARKET PARTICIPANTS

3.20 We asked engaged parties for their opinions on potential improvements which could be made to the process which might make shared ownership opportunities easier or more likely to occur. A summary of their feedback is included below, with further detail on how this may be applied to example investment models included in section 4.

3.21 Based on feedback and lessons learned from developers, early communication with communities was a key activity in creating a successful community ownership relationship. Furthermore, creating a transparent line of communication with the community about exactly what they can offer the from the outset (i.e., commercial model) is vital.

3.22 Developers and funders both noted that better coordination and organisation of the community would help make the shared ownership investments easier to negotiate, more cost effective to implement and increase their likelihood for success. Developers would ideally have one point of contact to represent a community's investment in a development, even if that represent multiple community groups, CARES can also provide support in this respect.

3.23 Developers need to recognise and consider that for the shared ownership investment offers to be taken up by communities, they must be structured to provide communities with sufficient security to be able to raise external funds and must be offered at a value that is commensurate with a minority stake investment and commercially viable verses the cost of funds that community groups have available to them.

3.24 A key takeaway from the discussions was the desire for knowledge sharing/lessons learned in the market between developers and funders, this would allow for the market to identify successful models that would suit their business and reduce the learning curve for developers new to shared ownership projects. Many developers highlighted a keenness to hear feedback from the market engagement exercise and a willingness to engage further in the process. Industry-wide guidance and knowledge sharing on what successful shared ownership investment models look like and what key considerations must be allowed for to ensure they work for all parties be beneficial. There were various comments around developing "standard" investment models, and while there was an acknowledgement that each project will have different requirements, an overarching structure(s) that developers, funders and communities could use would help support future investment.

3.25 Based on discussions with developers, there were varying interpretations of the Scottish Government's advice suggesting that clearer guidance is required to minimise ambiguity. Some developers even suggested that they would be in favour of a government mandate for shared ownership on all greenfield developments, provided it would have a demonstrable benefit in planning applications. Currently the perception was that offering shared ownership on prospective projects is viewed favourably by planning authorities but cannot materially influence a planning decision. It has greatest influence through generating community support for projects.

3.26 Several developers mentioned that they may consider implementing enhanced community benefit as an alternative as it is easier for developers to implement. They indicated the additional costs required to set up and manage shared ownership could be saved and provided to the community in an enhanced benefit which tracks the performance of the project, over and above the £5,000/MW installed capacity which is commonplace in the market. Developers added that this would be a risk-free benefit to the community, highlighting that this was an attractive option as it eliminated the community group's

investment and funding risks. This would not meet Scottish Government's shared ownership target or address the Good Practice Principles but highlights the current thought process of some developers.

## JV MODEL SPECIFIC

3.27 Below are some of the key points specific to a JV model derived from discussions with market participants. Further details on the key points stated below can be found the proceeding section. Detailed in section 4 are examples of funding security required for a community group to seek external investment and/or debt funding through a JV model structure.

- JV models are often viewed more favourably by funders of the community group, subject to the relative risk profiles of the community's investment and its funding structure (e.g. the community's investment may have equity return characteristics while the funding may be structured as debt), as they are familiar with the JV model and securities associated with a minority shareholding. Shared revenue models are currently likely to be bespoke and as such incur additional review, but may be favoured depending on the terms or structure of them.
- Management of SPVs will incur additional administrative time/costs to the community and developer. Historic community group entities may not be able to invest in a shared ownership JV model, new entities may be required, or alternative community entities (i.e., community trusts, development organisations) may be required to make the shared ownership investment.
- Developers' commercial structures can limit the applicability of a shared ownership JV model, for example if they do not have a separate Project SPV in which the community could acquire shares.

### RATIONALE

3.28 Half of the developers who participated in the process opted for a JV commercial model; they believe that this model provides the community group with tangible ownership in the project which they believe fully addresses the Scottish Government's principles for good practice by establishing a true 'financial partnership' with the community. Furthermore, developers stated that an equity model may be more conducive to community funding as their investment can be secured against the community's shares in the Project SPV. Another point raised by developers is that an equity investment could yield higher returns for the community group, allowing for a potentially larger margin on their funding costs to compensate them for their investment.

3.29 All funders engaged in this process noted that they may be able to fund a community group's equity stake in a project, highlighting minority shareholder rights and ability to have security over the communities shares in the Project SPV as a driving factor.

### COMMUNITY GROUP SECURITY

3.30 Funders expressed that they would require security measures typical of a minority shareholder to make them comfortable funding a communities shared ownership stake which include, security over the shares, direct agreements, and step-in rights. Step-in rights may be stipulated by a funder where-by they have the right to step-in to the community equity position in the Community SPV in the event of insolvency of the entity, adopt the community group's board representation in the case of the community group breaching or approaching loan covenants to input to project decisions. A direct agreement is a contractual arrangement with the funder and developer whereby in the case of community group SPV insolvency, the funder will be paid directly by the developer to service any

outstanding debts. Several funders required or strongly preferred the ability for the community to have a representative board seat in the Project SPV.

3.31 In general, developers stated that they would not offer board representation or voting rights in the Project SPV to the community as a minority shareholder, highlighting that the variation in community group competence and additional bureaucracy will hinder efficient project decision making. Some funders stated they would like the option to adopt the community group's board position in the Project SPV where available in the case of the Community SPV breaching or approaching loan covenants due to poor project performance.

### CHALLENGES

3.32 Developers highlighted that JV models can have challenges, some of which relate the management of Project SPVs. Some developers noted that the additional carrying cost and time required to manage Project SPVs can be significant and add additional complexity to projects. Additionally, developers noted community group structures can add additional challenges if they have been created historically other than for the purpose of the shared ownership investment. Several developers/funders have offered to set-up the community project vehicle to streamline this process.

3.33 Some developers noted that minority equity stakes, particularly above 10% can cause a drag on asset valuations and dissuade investors in a future sale process, furthermore a larger community ownership entitles the community to have greater investor rights which most developers were reluctant to issue.

3.34 Developers that hold assets on their balance sheet rather than in individual Project SPVs are not structured in a way to support JV shared ownership models (as each project does not have a separate company for which shares can be issued) which limits the application of JV model as a standardised approach in the broader market. Furthermore, some developers structured on this basis noted they procure some services (for example turbine maintenance) as a group so may struggle to attribute costs to individual projects, particularly on an open book basis.

3.35 Funders and developers both highlighted that an equity investment may carry more risk for the community group, when compared to a revenue share agreement (when structured to be senior to equity, and potentially debt or operating costs, in distributions) who are unlikely to be sophisticated investors and therefore may not fully understand the investment risks associated with an equity investment. With that said, a riskier investment will likely yield better returns for the community (if the investment performs as, or better then, expected.

3.36 Furthermore, the parties raised concerns that the Community SPV carries a risk of not being capable to withstand downsides due to losses caused by poor project performance.

## SHARED REVENUE MODEL SPECIFIC

3.37 Below are some of the key points specific to shared revenue model derived from discussions with market participants. Further details on the key points stated below can be found in the proceeding section. Detailed in section 4 are examples of funding security required for a community group to seek external investment and/or debt funding through a shared revenue model structure.

- A shared revenue model can be applied even if there is no Project SPV and has a simpler commercial structure compared to a JV model.
- Shared revenue models can provide communities varying levels of risk and returns by altering the revenue share agreements position in the cash waterfall.
- Developers retain all equity in the project in a shared revenue model.
- Not all community group funders were willing to lend to a shared revenue model given lack of familiarity with the model. Funders that would consider lending will require similar rights as under a JV model.
- A net revenue share model has the potential for misalignment of incentives between developer and community in short-term but converge over the project life.
- Shared revenue model may not be in line with Scottish Government Good Practice Principles for Shared Ownership of Onshore Renewable Energy Developments.

## RATIONALE

3.38 The remainder of developers offered a shared revenue commercial model stating that this model was simple to implement, more cost/time effective given that there is no requirement for Project SPVs and removes the need for a minority shareholder involvement in Project SPVs if they do exist. Furthermore, developers operating a shared revenue model believe that it satisfies the Scottish Government's principles for good practice while allowing them to retain full ownership of the project.

3.39 Developers who were restricted by their ownership structure in offering an equity stake opted for a shared revenue model which would allow them to fulfil the Scottish Government's criteria within the boundaries of their corporate structure. Furthermore, developers operating under Project SPVs can offer shared revenue models where a JV model is not possible, making the model applicable across the market.

3.40 Some developers stated that they selected a shared revenue model based on their view of it being the most widely used shared ownership model in Scotland, highlighting that they did not want to use a model that was unfamiliar to the market as it may impact/decrease asset valuations (this was the view of some specific developers and is not necessarily a market view).

3.41 With a shared revenue model, developers highlighted that there was more flexibility to offer different risk profiles to community groups based on where in the cash waterfall the shared revenue agreement was taken.

## COMMUNITY GROUP SECURITY

3.42 In a shared revenue model, the community group is a passive investor which holds no shares in the project, therefore the community is not necessarily entitled to any statutory shareholder rights (although these could be replicated contractually). Funders, however, indicated they would only be able to fund the community’s stake if the shared revenue offered sufficient security, which may be in line with the similar security and rights attached to a minority equity stake.

3.43 Appreciating the security requirements of community group funders, some developers indicated they may be able to provide a minimum return guarantee for a specific period which would limit the downside risk to the community and allow them to maintain debt service payments. With that said, the

reduction of risk to the community may then be reflected in a reduced return on investment used to calculate the initial investment requirement.

## CHALLENGES

3.44 Some funders expressed that they would not be able to fund a community group that is offered a shared revenue offer, stating that they require security measures equivalent to those of a JV model as noted in section 3.30 of which are not standard for developers. They may be able to if a similar risk position was achieved.

3.45 Based on responses from developers operating shared revenue models, there was a mixed application of gross and net shared revenue models applied in the market. A gross revenue share is the lowest risk point in the cash waterfall as the community group is only exposed to performance risk which factors in wind availability, turbine availability and electricity price risk. As this is lower risk than a revenue stream that is subject to operating costs, developers typically seek a higher upfront investment (i.e., at a lower discount rate) which after funding costs may leave less upside on the community investment.

3.46 In a net revenue share model, there is a potential for misaligned objectives between the community and the developer in terms of the ongoing operating expenses whereby the community gets a lower return when operating expenses incurred by the project are greater. With that said, provided incurred operational costs are reasonable, over the long term the net revenue investors views will be aligned with those of the developer as prudent maintenance of the assets will improve future operational performance and life of the asset.

3.47 Based on a review of bidding criteria for developments on Scottish Government land, there is a strong preference for a JV model structure over shared revenue models. Given the large pipeline of projects on Scottish Government land, this could limit the application of shared revenue models to projects on private land developments.

# 4. Example model funding requirements

4.1 Based on discussions with developers, funders, and community groups some examples were raised of requirements that would be needed to enable the communities to be able to raise funds to invest in the projects raised. Outlined in Table 3 below and further expanded in section 4 is a summary of the specific requirements that community groups are likely to require to be able to raise finance to support a shared ownership investment in each of the commercial models. A more detailed table is attached in Appendix 4. Each project would need to be assessed on its own merits to find appropriate structure and protections that would allow funding to be raised but also be acceptable for the developer and community.

*Table 3: Structural features of JV and shared revenue operating models.*

| | Joint Venture | Shared Revenue |
|---|---|---|
| Minimum requirements | •Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Access to financial information and project decisions that may impact shareholders return<br>• Protections in the event of a sale<br>• Minority shareholder rights | •Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Access to financial information and project decisions that may impact shared revenue investors return<br>• Protections in the event of a sale or termination<br>• Equivalent protection to minority shareholder rights written in to contract |
| Likely additional minimum requirements where community needs external funding | • Security over the Community's Project SPV shares<br>• Step-in rights to act in place of Community | • Security over contracted revenue agreement<br>• Step-in rights to act in place of Community |
| Additional aspects that could provide communities with access to more funding options at better rates | • Project SPV board representation<br>• Security over community benefit income<br>• Minimum return guarantee/loan floor note<br>• Structural protections included in operating contracts (e.g. LDs or performance guarantees in O&M contracts) | • Project SPV board representation<br>• Security over community benefit income<br>• Minimum return guarantee/loan floor note<br>• Structural protections included in operating contracts (e.g. LDs or performance guarantees in O&M contracts) |

## JOINT VENTURE MODEL

4.2 A basic joint venture model is outlined in Figure 5 below, assuming the project is debt and equity funded. The community structure will vary depending on the funding provided to the community group.

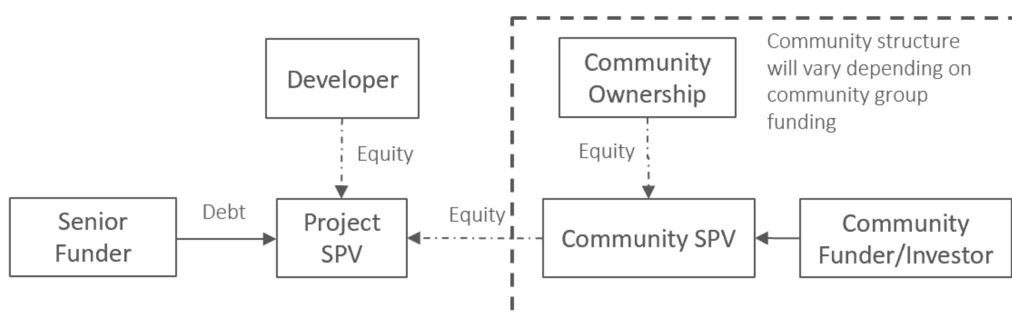


*Figure 5: Basic shared ownership joint venture model.*

## EQUITY INVESTMENT

4.3 Communities may have access to sufficient capital to make the investment into the project itself, however, this is not typical and communities usually need to raise external funds to make shared ownership investments.

4.4 An equity investor in a community shared ownership JV requires the following securities/rights as a minimum:

- Access to operational performance and project decisions that may impact shareholders return: Equity investors should have regular access to information on their investment which could include operational performance of the project, ongoing operational costs, board meeting notes, operational decisions that may impact investment return etc.
- Minority shareholder rights: An equity investor in the Community SPV will have shareholder rights equivalent to their ownership stake percentage in the community vehicle, as per The Companies Act 2006.
- Protections in event of sale: In the event that the developer sells the project then the Community would like the option to sell on the same terms, or not and for its rights to the shared investment to continue.

## COMMUNITY SELF-FUNDED

4.5 In the case where the community has the entirety of the funds to take up the developer's JV shared ownership offer, the Community SPV will be wholly owned by the community group such that they will be entitled to standard equity rights detailed in section 4.4.

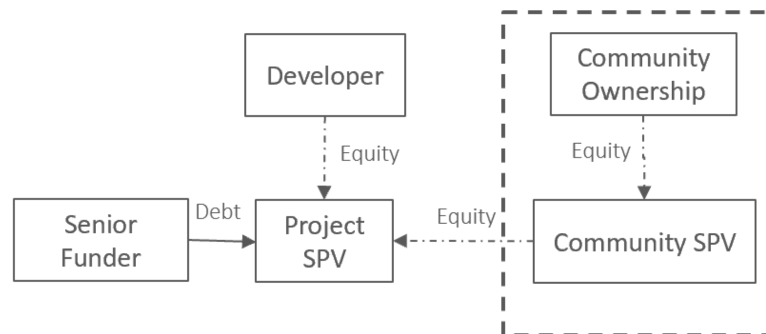


*Figure 6: Community self-funded shared ownership JV structure.*

## CROWDFUNDING/EQUITY INVESTOR

4.6 Equity crowdfunding is a form of equity investment whereby the investor would require equivalent equity rights detailed in section 4.4, however crowdfunding platforms may restrict the size of individual investments such that they would not reach a shareholding position to command rights over the Community SPV. It is important to note that crowdfunding can also be used to raise debt, in such cases crowdfunding may receive a preferential return over equity.

4.7 Communities may also raise funds from other investors in the form of selling equity, for example from local people in the community, and it does not necessarily need to come through a crowd funding platform. A debt provider may also invest equity into the Community SPV, in such cases the debt securities will be the determining requirements of the arrangement. Some investors/funders highlighted they can invest equity into the project which can be bought back by the community over time. Where this is the case, the equity investors' rights will reduce as the community buys out their equity position.

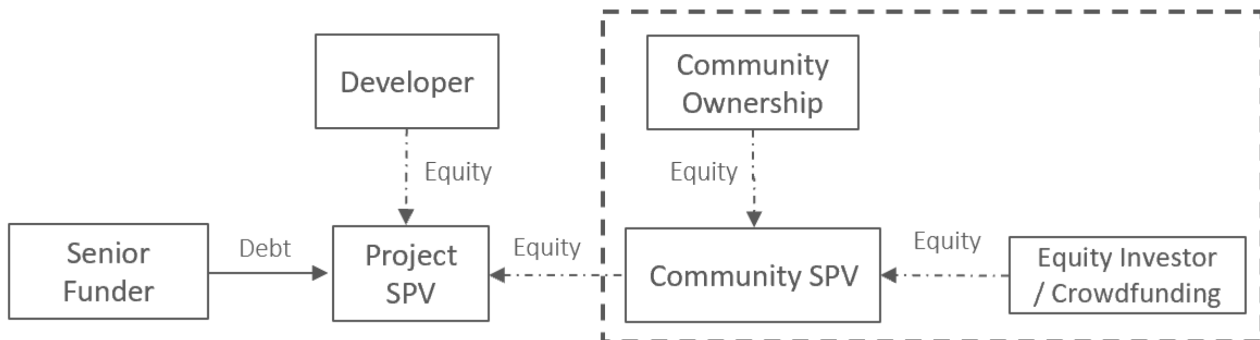


*Figure 7: Equity/crowdfunding shared ownership JV structure.*

## DEBT FUNDED

4.8 In a debt funded case, the community group funder would provide debt to the Community SPV such that the community could purchase the shares in the Project SPV. A typical debt funded shared ownership structure is outlined in Figure 8 below.

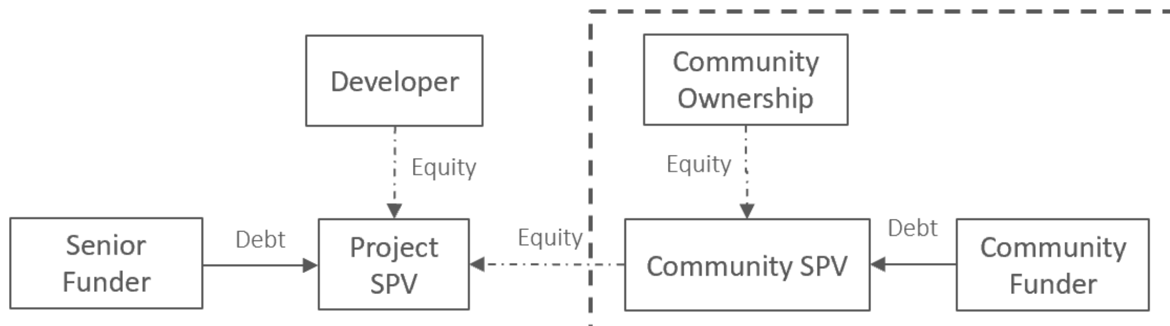


*Figure 8: Debt funded JV model structure.*

4.9 Minimum requirements funders fed back to enable them to lend to a community's shared ownership investment include:

- Security over Project SPV shares: The community's funder would usually require security over the Project SPV shares held by the Community SPV.
- Step-in rights: The community funder would require step-in rights to the Community SPV in the event of a default on the loan. In such situations the funder would take the community's equity position in the Community SPV and therefore take control of the entity. The community funder may also require a direct agreement with the developer such that in the event of a Community SPV liquidation, existing agreements with the community would be transferred to the community group funder so that they would receive the communities share until the point their debt has been repaid.

4.10 Over and above the minimum criteria, there are several factors that could improve community groups' access to a wider pool of debt funders and potentially reduce the cost of debt funding which include but are not limited to:

- Project SPV board representation: Having board representation in the Project SPV could improve the community's funding terms as the community would have access to more information of the project and potentially the ability to vote on project decisions and influence board decisions.
- Security over community benefit income: In cases where the Community SPV also receives the community benefit payment, the community funder may require security over this payment such that they can access these funds should the Community SPV fail to meet debt service payments from the JV dividends.
- Minimum return guarantee/loan floor note: If the community group is offered either a minimum return guarantee or a loan floor note, this would be advantageous to its position with a funder as this could be set at a level above the debt service cost which would ensure that the community had sufficient income to meet funder payments, even in times of poor operational performance.
- Structural protections in operating contracts: It would add greater certainty to future revenues, and profits, where the operating contracts include minimum levels of performance or availability with associated deductions or compensation being payable where these levels are not met. This could reduce the project, and as such the investment, risk profile and potentially enhance the ability to raise external funds.

## MONETISED COMMUNITY BENEFIT

4.11 In the case where the community group investing in the shared ownership opportunity is also the same community that receives community benefit payments, the community may decide to monetise its future community benefit payments to fund its investment, provided the developer can facilitate this arrangement. This would effectively be a mechanism for the community to raise equity and may remove the need for external funders to support community group investments. The community would forgo some of its future community benefit payments in exchange for an upfront lump sum.

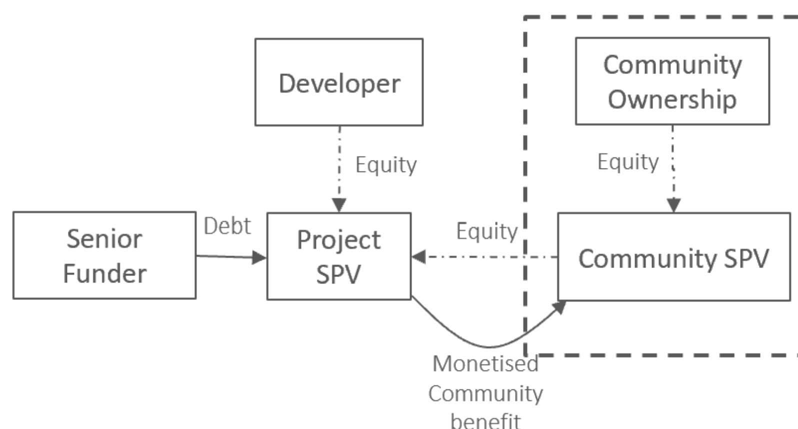


*Figure 9: Monetised community benefit shared ownership JV structure.*

## DEVELOPER LOANS

4.12 Although not commonplace in the market, there have been situations where the developer has offered to provide a loan to the community which is then used to make a shared ownership investment. Any developer considering making a loan to a community group should seek appropriate advice and ensure it complies with FCA and regulatory requirements. There may be legal implications to consider which

may influence the investment and/or loan structure and appropriate advice should be sought. Communities should also seek specialist advice when considering accepting a developer provided loan.

4.13 The advantage of the developer providing the loan for the investment is that they have full oversight of the project performance and operation such that they may have less onerous security requirements compared to an external funder. The community will still seek to maintain investor protections, which may include access to project performance data and minority shareholder protections.

## SHARED REVENUE MODEL

4.14 A basic shared revenue model is outlined in below, where the community structure and distributions will vary depending on the funding provided to the community group and the type of revenue share agreement model. It is important to note that some developers do not hold projects within Project SPVs, in such cases the developer will take the place of the 'SPV' in the figure below.

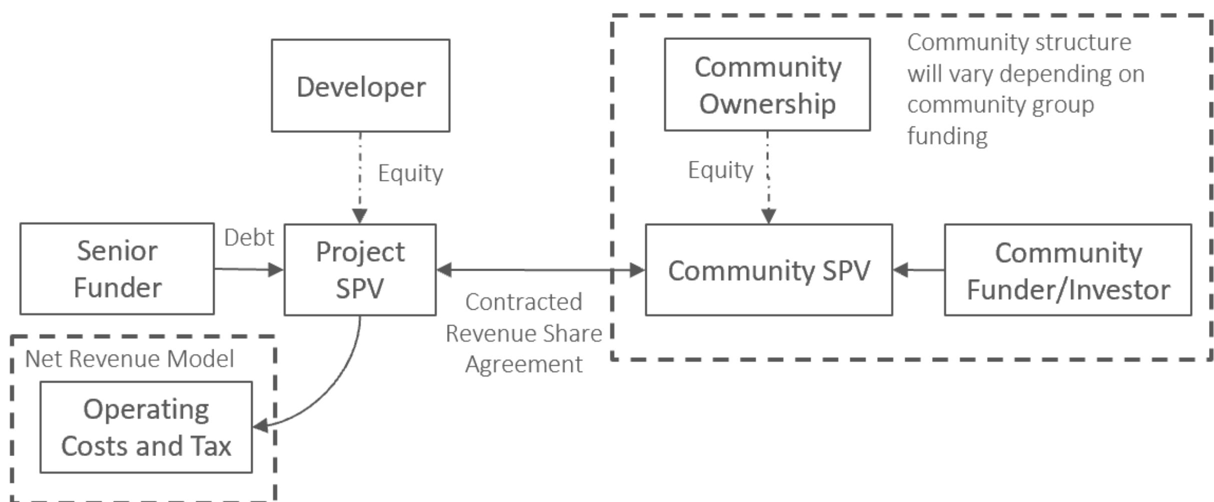


*Figure 10: Basic shared revenue model. Gross revenue will be a share of revenue prior to operating costs and tax whereas a net revenue share will be of revenue after certain agreed costs and deductions.*

## EQUITY INVESTMENT

4.15 For a pure equity funded case, the level of investment securities required are likely to be less stringent than in a debt financed investment. However as mentioned above, shared ownership investments typically involve a portion of debt funding. With that said, equity investments cover community self-funding and monetising community benefit payments. It is important to note that an equity investment in this case is for shares of the Community SPV that holds the contracted revenue share agreement with the Project SPV or developer.

4.16 An equity investor in a Community SPV with a shared revenue agreement would usually require the following securities/rights:

- Access to operational performance and project decisions which impact the shared revenue agreement: An equity investor will require access to regular updates on the operational performance of the project to ensure that the asset was performing in line with valuations. In net revenue models, further details such as operating and maintenance expenses that occur prior to the community's distribution will be required to be disclosed such that the investor can evaluate that expenses are reasonable and not

overstated to reduce the distributions paid out to the community and community funder. This will be of particular importance to Communities where subcontractors are an affiliate of the developer.

- **Protections in event of sale or termination:** In the event that the developer sells the project then the Community would like the option to sell on the same terms, or not and for its rights to the shared investment to continue. Termination clauses to protect the community's investment would be sought.

## COMMUNITY SELF-FUNDED

4.17 In the case where the community has the entirety of the funds to take up the developer's shared revenue offer, the Community SPV will be wholly owned by the community group 4.19.

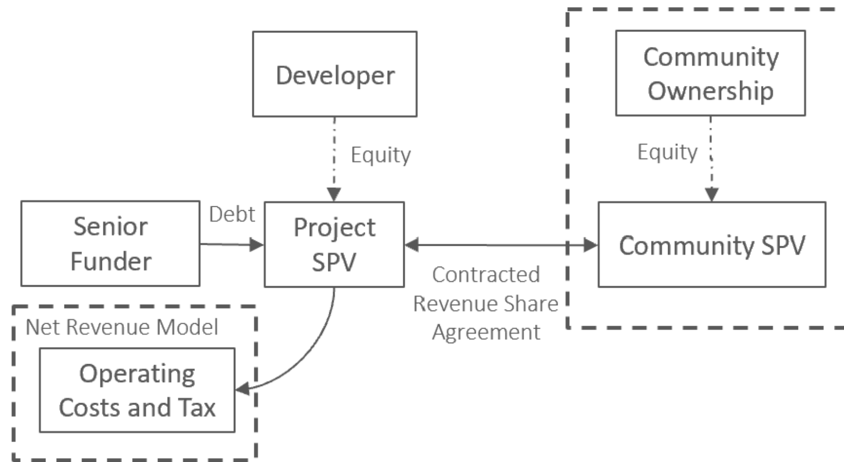


*Figure 11: Community self-funded shared revenue model.*

## CROWDFUNDING/EQUITY INVESTOR

4.18 Equity crowdfunding and equity investors in a shared revenue model will have similar considerations as noted in the JV model (section 4.9 and 4.16). Figure 12 below shows the shared revenue model with equity investors or crowdfunding.

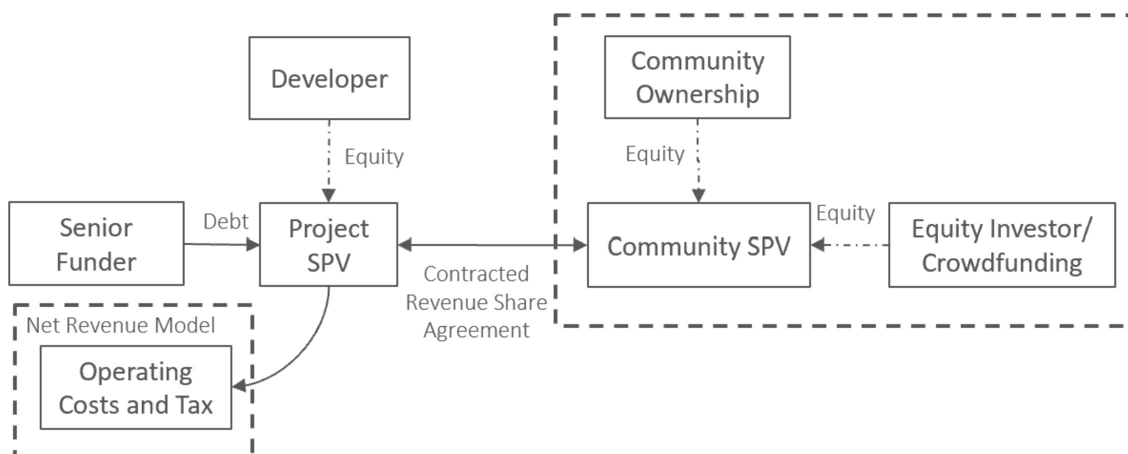


*Figure 12: Crowdfunding/equity investor in a shared revenue model.*

## DEBT FUNDED

4.19 Where debt is being used to fund a shared revenue investment, the community group funder would provide debt to the Community SPV such that the community could purchase a share of future Project SPV cashflows. A typical debt funded shared ownership structure is outlined in Figure 13 below.

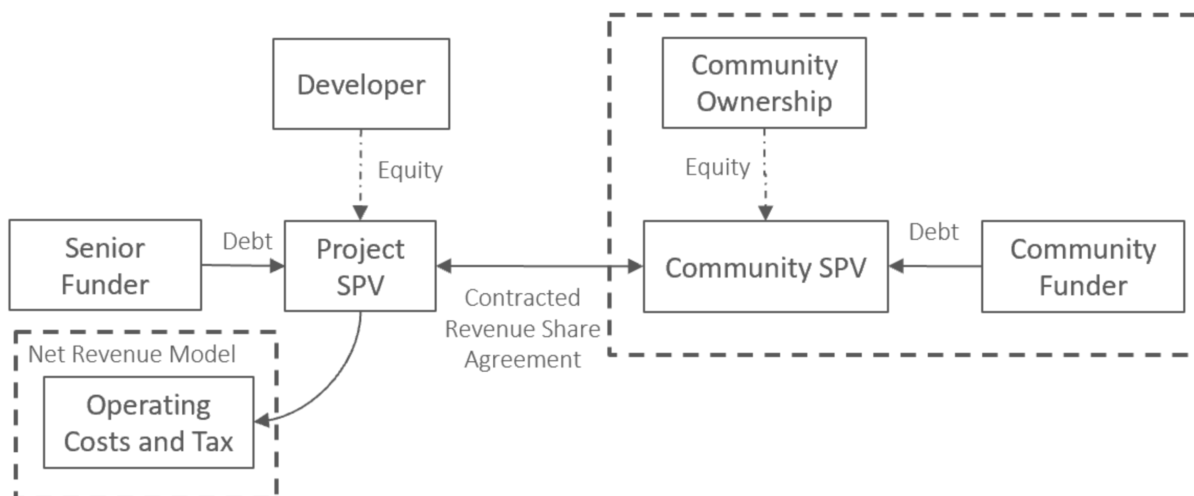


*Figure 13: Debt funded shared revenue model.*

4.20 The community group's funder may require security over the Community SPV. In each shared ownership project that was discussed with participants in the market, the community group always required debt funding for a portion of or the entirety of their shared ownership investment although not all funders would be willing to lend debt to into a shared revenue model.

4.21 Minimum security requirements in order to raise debt for a community shared revenue investment:

- Minority shareholder rights: Contract should include provisions which provide the same level of protection that an equity investor in the Project SPV would have.
- Security over contracted revenue agreement: Community funder would need security over the contracted revenue share agreement such that they would receive these revenues should the Community SPV fail to service its debt repayments. This may be via security being granted over the Community SPV shares.
- Step-in rights: The community funder would require step-in rights to the Community SPV in the event of a default on the loan. In such situations the funder may take the community's equity position in the Community SPV and therefore take control of the entity. The community funder would also probably require a direct agreement with the developer such that in the event of a Community SPV default, existing revenue share agreements with the community would be transferred to the community funder so that they would receive the communities remaining agreement until the point their debt has been repaid.

4.22 Over and above the minimum criteria, there are several factors that could improve the community group's debt funding cost/availability which include but are not limited to:

- Minimum return guarantee/loan floor note: In a shared revenue model the community does not have shares in the Project SPV so the lender may require either a minimum return guarantee or a loan floor note such would guarantee the funder's debt service costs will be met regardless of operational performance.
- Project SPV board representation: Having board representation in the Project SPV could improve the community's funding terms as the community would have the ability to vote on project decisions and influence board decisions. This is of particular importance for a net revenue share agreement where operational/governance decisions directly impact the communities return and consequently the funders.
- Security over community benefit income: In cases where the Community SPV also receives the community benefit payment, the community funder will likely require security over this payment such that they can access these funds should the Community SPV fail to meet debt service payments from the shared revenue income.
- Structural protections in operating contracts: It would add greater certainty to future revenues, and profits, where the operating contracts include minimum levels of performance or availability with associated deductions or compensation being payable where these levels are not met. This could reduce the project, and as such the investment, risk profile and potentially enhance the ability to raise external funds.

## MONETISED COMMUNITY BENEFIT

4.23 In the case where the community group investing in the shared revenue model opportunity are also the same community that receives community benefit payments, the community may decide to monetise their future community benefit payments to fund their investment, provided the developer can facilitate this arrangement. This would effectively be a mechanism for the community to raise equity and may remove the need for external funders to support community group investments. The community would forgo some of its future community benefit payments in exchange for an upfront lump sum.

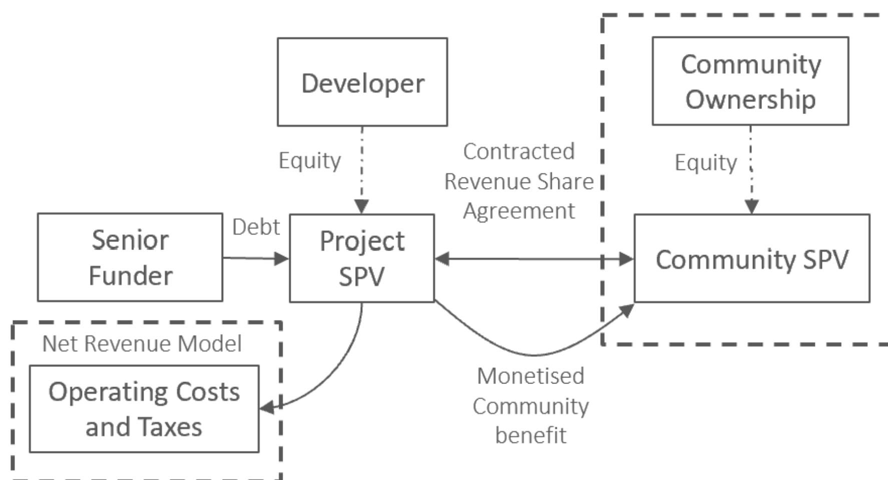


*Figure 14: Monetised community benefit shared revenue model.*

# 5. Summary conclusion and recommendations

## CONCLUSION

5.1 Community groups generally have limited to no cash available to use for a shared ownership investment so they will require additional funding to make the investment. For a shared ownership investment to be commercially viable for the community, the community's return on investment must exceed its cost of funding. Debt funding costs are typically priced at the market funding rate which will be a variable reference rate (e.g., Sonia or Bank of England base rate) plus a margin. If developers want community ownership in the project they must be cognisant of this when pricing their offers to communities. In cases where these conditions do not align for the community group, shared ownership is unlikely to be commercially viable.

5.2 There is not a "one size fits all" approach that can be adopted in the shared ownership market, various limitations imposed by developers, funders and community groups restrict the applicability of a single model to suit all parties.

5.3 With that said, there is a desire from developers and funders for a standardised model(s) or framework which can be used as a basis for shared ownership offer structures. This could then be refined to suit the individual specifics of the developer, funder or community group. The feedback from developers was that each developer is having to create a model from first principles and adapt the model as the project and discussions with communities progress, which has a cost (resource, time), is harder to get agreement on internally as they cannot point to a market benchmark and a risk factor associated with the offer being successful (e.g. the newly developed offer may not work for the community or its funders). If there was a framework this would streamline this process and help address these issues. Similar feedback was received from funders of the community groups.

5.4 The funding market for community groups is yet to reach maturity, with the funding pool currently limited to specialist or boutique lenders, of which there are few, with an investment size ranging from £1m-£30m, although transactions to date have been towards the lower end of the range. The recent withdrawal of EIF, which was historically an active funder in community shared ownership projects, has reduced the funding options available to communities. Smaller lenders can provide additional services to community groups such as setting up a Community SPV among other services There could be an opportunity for a lender or government entity to fund several projects to provide proof of concept, while using a relatively standardised loan offer and associated community investment structure, which may increase activity from the wider funding market in the sector. Although not commonplace, the developer may also provide funding to the community to support their investment on a case-by-case basis.

5.5 Debt funders into a community shared ownership investment carry the greatest security requirements of any other lender/investor and those requirements are typically the limiting factor that restricts community group's access to funding where the funders security requirements cannot be met by the developer.

5.6 In a shared revenue model arrangement, community group funders would usually require similar rights to a minority equity shareholder in the project in order to provide funding. Developers and community groups will need to be aware of this when entering a shared ownership arrangement where external community debt funding is required.

5.7 All investment models discussed were on the basis that the community will form an SPV to make the investment into the project, whether it is a shared revenue or JV investment opportunity. It is that Community SPV which would then secure the funds to make the investment, either from the community itself, via the project or from external sources.

5.8 The diagram below outlines the high-level security requirements of a community funder, and other contributing factors that may improve the funding terms of the agreement for the community group.

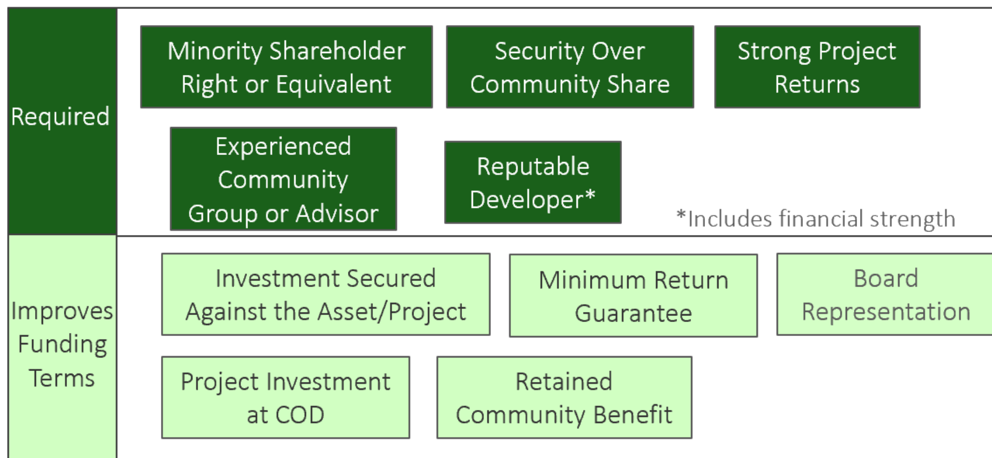


*Figure 15: General community funding requirements.*

5.9 Where some of these terms outlined in Figure 15 are not possible, this could increase the funding cost to the community in the first instance, reflecting increased risk to the funder and/or reduce the amount of capital the lender is willing to provide (reducing the funder's exposure to the investment). In some cases, the limitations on the project may restrict the lender from being able to fund a community's stake in a project.

5.10 It should be recognised that shared ownership requires a willing developer and community group in order to get the project to development. Developers should also recognise that having the community involved through shared ownership will incur some cost (time, resource, and money) and may not be cost neutral. With that said, there may be business rates relief or other benefits which are available to projects with community shared ownership. By appointing specialist advisors (e.g., legal, tax and finance) through CARES grant funding, communities can leverage these cost offsets in negotiations with developers. The intangible value of having community shared ownership, if recognised, may help developers generate internal support, particularly where the developer is considering other development opportunities in the area or repowering.

5.11 Developers stated that they would prefer to only engage with a single community entity when making shared ownership negotiations and that entity must also be the same entity that makes the investment. This is likely to be the case for funders too and as such communities should be cognisant of this when coordinating their approach to the shared ownership investment.

## RECOMEDATIONS

5.12 There was broadly a consensus amongst developers, funders and communities that a standardised approach to a shared ownership investment model (or models to the extent some flexibility is required in the investment structure, for example a standardised joint venture model and standardised shared revenue model) would help support more projects deliver community shared ownership investments going forward. A standardised approach would have the following benefits:

- Reduce uncertainty on how shared ownership might be implemented, benefitting communities who may need to organise to be ready for an investment opportunity and reducing uncertainty for developers on how shared ownership may impact projects commercially during development.

- It should be more efficient and cost effective to implement, reducing time and cost burden for developers, communities and funders therefore improving the commercial viability of the shared ownership offers. The current process where each developer/funder needs to repeat the process of creating a model from first principles incurs additional project costs which can dissuade developers and funders from progressing with shared ownership offers.

- It could be seen as market standard, and theoretically become the "norm", as such helping to address some developer concerns that any deviation from a "market standard approach" to an energy project may negatively impact valuation.

- Once tried and tested, the proof of concept and market size would be evidenced and so potentially support interest from new funders to support communities' investments. This may help broaden the funding available and increasing the competition within the market, potentially driving down the communities' cost of funding and increasing the commercial viability of shared ownership investments.

5.13 To be effective the standardised approach should include detail on the investment structure. While not fully comprehensive, this should include the nature of the community investment vehicle, minimum requirements that community investment vehicles must have (e.g. demonstrate sufficient knowledge and expertise or have appropriate support), clearer guidance on expected investment terms (e.g. valuation approach or community return requirements, distribution mechanisms), tenor of investment, detailed draft of the investment agreement (e.g. shareholders agreement or shared revenue agreement) and any mandatory reporting required from the developer (e.g. project performance reports).

5.14 It is worth recognising that some of the specialist funders have already developed bespoke investment models which have worked to date and which could help inform the creation of the standardised approach (as it has informed some of the discussions within this engagement exercise).

5.15 We have noted below several potential recommendations and observations which could help to develop market more broadly:

1. Produce a draft of example shareholder agreement for a joint venture investment and shared revenue agreement for a shared revenue investment and guidelines on community investment structure which can be shared publicly. This should draw on the outcomes from this report and take consideration of interests from all stakeholders (developers/project owners, communities and funders (community funders and project funders).

2. When a framework or example funding agreement model has been drafted, the models should be tested, ideally using live shared ownership offer opportunities, feeding back improvements to enhance the framework and evidencing proof of concept and commercial viability. Support in the form of a willing community lender and any contribution to costs (to the extent not already available via LES) may be required to enable the initial investments to occur.
3. The Scottish Government Good Practice Principles for Shared Ownership of Onshore Renewable Energy Developments has been successful in forming the basis of share offers from developers. However, general feedback from developers highlighted that clearer guidance could be provided, particularly on the approach to valuation. Several developers had different interpretations of the guidance, particularly with regards to the statement "shared ownership in a renewable energy project should not reduce the overall economic viability of the project". Some interpreted this statement to mean that shared ownership should be valued at an equivalent level that would be achieved by selling the whole project to a third party. Furthermore, the discount rate applied often did not consider that a minority share, similar to that which a community would have, sold on the market would command a higher discount rate (lower price). This may result in the investment offer being unviable from a community's point if the rate of return on its investment is below the community's cost of funds. Other developers have followed the good examples laid out in the guidance and have valued the communities offer at cost of development or at a discounted market rate, both of which are more conducive to funding and more likely to be commercially viable. Clearer guidance in this respect would remove any ambiguity of the guidance and standardised the valuation approach.
4. Increase awareness of the benefits of shared ownership and help to quantify these to include within the valuation approach. For example, giving projects access to business rates relief. The clearest benefit noted by developers of including shared ownership offers was to improve community engagement and support in projects (as communities that are invested in the project are aligned on the successful development and operation) which they ultimately viewed as having an implied positive impact during planning process. However, several developers, and communities, did note that there is no material weighting given to shared ownership during the planning process, and as such this benefit was in some cases hard to quantify or reflect in internal business cases (when there is a perceived cost or reduction in investment size resulting from the inclusion of shared ownership). Any stronger incentives that can be made to entice developers to make commercially viable (for communities and developers) shared ownership offers will significantly improve the occurrence of shared ownership investments.
5. Specialist advice (tax and legal) could be sought on whether particular community investment structures could ensure the community is able to full realise any reliefs which may be available to it. For example, if the community investment vehicle is registered as a charitable body (or is wholly owned by one) then it may receive relief on corporation tax, however this may not be able to be recognised within some investment structures. One possible way of enabling a charitable community investor to access this relief may be to invest in the project via a limited liability partnership (LLP), i.e., the Project SPV would be an LLP, through which any members (instead of shareholders) are responsible for payment of their own tax, rather than it residing with the corporate entity as it does under a limited company structure.
6. There seemed to be a lack of understanding of shared ownership both from funders not currently involved in the sector and from developers who have not yet taken projects through with a shared ownership offer attached. This is potentially limiting wider market interest in the shared ownership opportunities and also may be steering potential stakeholders to favour investment models they are

more familiar with (e.g., funders typically noted a preference for JV models, which may in part due to a lack of understanding in potential security provided under a shared revenue agreement).

In addition to the production and dissemination of a standardised investment model, LES's existing and planned role in providing a platform for knowledge sharing will help to address this, for example by conducting targeted educational material or workshops with developers, funders and communities who have no experience in shared ownership. This could be tailored to be specific to each shareholder and can include some of the conclusions from this initial market engagement exercise. A summary of the structural requirements for both joint venture and shared revenue models are detailed in **Error! Reference source not found.**

Table 3

| 7. | Joint Venture | Shared Revenue |
|---|---|---|
| Minimum requirements | •Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Access to financial information and project decisions that may impact shareholders return<br>• Protections in the event of a sale<br>• Minority shareholder rights | •Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Access to financial information and project decisions that may impact shared revenue investors return<br>• Protections in the event of a sale or termination<br>• Equivalent protection to minority shareholder rights written in to contract |
| Likely additional minimum requirements where community needs external funding | • Security over the Community's Project SPV shares<br>• Step-in rights to act in place of Community | • Security over contracted revenue agreement<br>• Step-in rights to act in place of Community |
| Additional aspects that could provide communities with access to more funding options at better rates | • Project SPV board representation<br>• Security over community benefit income<br>• Minimum return guarantee/loan floor note<br>• Structural protections included in operating contracts (e.g. LDs or performance guarantees in O&M contracts) | • Project SPV board representation<br>• Security over community benefit income<br>• Minimum return guarantee/loan floor note<br>• Structural protections included in operating contracts (e.g. LDs or performance guarantees in O&M contracts) |

on page 26 and further expanded in Appendix 4.

# Appendix 1. Terminology and definitions

### PROJECT SPV

6.1 The Project SPV in the context of this report refers to the special purpose vehicle that holds the shares to the low carbon energy project that the community are being offered shares/revenue share within. The Project SPV will distribute dividends to the Community SPV in a JV model or have a contracted revenue share agreement with the Community SPV in a shared revenue model.

### COMMUNITY SPV

6.2 The Community SPV is the communities shared ownership investment vehicle that will either hold shares in the Project SPV in a JV model or have a contracted revenue share agreement with Project SPV in a shared revenue model.

### GROSS AND NET REVENUE

6.3 Gross revenue is the total income generated by the SPV before any operating costs and taxes. Net revenue is the gross revenue less tax and deductions. When a developer offers a net revenue share model, they need to clearly stipulate what deductions will be made prior to distributing the communities share of the revenue. The risk profile for the community increases the further down the cash waterfall the revenue is taken from which is reflective of a reduction in ranking seniority.

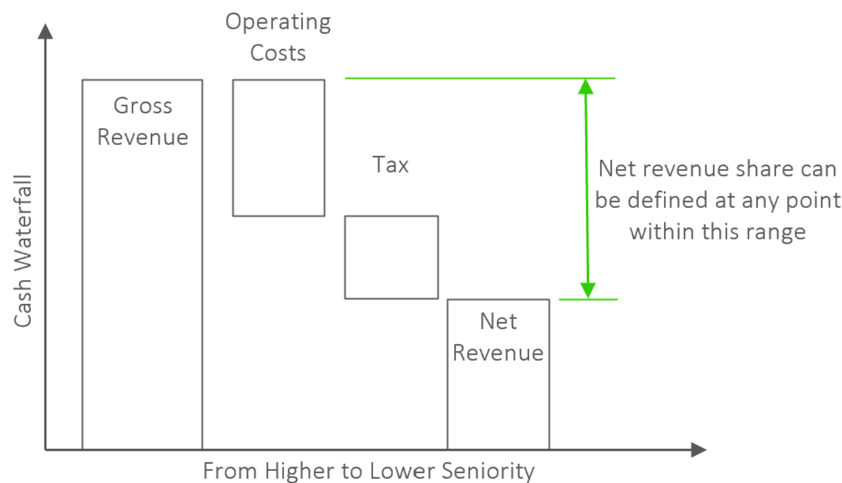


*Figure 16: Example of a cash waterfall and different shared revenue models.*

### STEP-IN RIGHTS

6.4 Step-in rights are a legal clause which will allow one party to take the place of another if certain conditions are reached. Step-in rights are often used as a security requirement of funders which would allow them to step-in to an SPV or contract in place of the funded group, as such that they would step into the equity position or community position of a shared revenue agreement. Once a funder decides to step-in, they cannot then step-out and must then absorb the responsibilities of the agreement. Situations in which a funder may exercise step-in rights include default under the loan agreement by the funded party or a serious breach in contract among other cases. Since community groups are classified as a retail client, funders lending to these groups often stipulate step-in rights in the event

that the community group is struggling to service its financial obligations, in such a case the funder would step-in to the Community SPV leaving the funder with full control of the Community SPV and all associated shares in, or contract with, the Project SPV.

## DIRECT AGREEMENT

6.5 A direct agreement is like a step-in agreement, in that a funder could step-in to the shoes of the Community SPV in the event of a breach of pre-agreed contract, however a direct agreement is an agreement between the funder and the Project SPV (rather than between the funder and the Community SPV). A direct agreement gives funders a direct route to engage with the Project SPV and a direct route for recourse if the Community SPV does not perform or is becomes insolvent. A direct agreement can also stipulate a preferential return clauses whereby the funder would receive first payment ahead of the community group in such a case that the returns of the project were lower than the debt service cost. A direct agreement is important for a funder as in the case of insolvency of the Community SPV, contracts between the Project SPV and Community SPV could be null and void, thereby a direct agreement would be in place for such a case so that the developer would then pay the funder the outstanding balance until a time that they are made whole.

## INVESTOR

6.6 For the purposes of this report, an investor is any party that provides equity to the project. An investor would be the community group whom owns shares in the Community SPV, equity crowd funders or third party equity providers.

## FUNDER

6.7 In the context of this report, a funder is the provider of debt. There may be a senior funder to the Project SPV that will fund the Project SPV and/or a senior funder to the Community SPV that will fund the community's shared ownership investment. References to a funder in the report is to a funder of the Community SPV unless stated otherwise.

## DISCOUNTED CASH FLOW

6.8 Discounted cash flow is a valuation method used by developers to determine the value of net present value of the investment based on the developers cost of capital. The net present value of the project will be used by developers when determining the amount of capital the community group should invest based on their share offering.

# Appendix 2. Community funding options

7.1 Community groups have several funding routes that they could consider when making a shared ownership investment in a low carbon project. The funding options available community groups will vary based on their particular circumstances, size of funding required, shared ownership model being offered, funds available in the community, and individual investor appetite among other contributing factors. Outlined below are the main funding options that a community could consider when making a shared ownership investment.

## COMMUNITY FUNDED

7.2 The community group could invest its own cash in the project should it have the resources to do so. The cash invested by the community could come from several sources, such as local fundraising activities, accumulated funds from community benefits received from operational projects or charitable donations. Community funds can typically also be used in conjunction with other funding methods to reduce the overall funding requirement from third party funders.

## CROWD FUNDING

7.3 Crowd funding is a method of pooling funds from individual investors who receive a proportionate stake in the project, based on the sums invested. Crowd funding can be an effective way of generating funding as the investor base is not limited to locals, although they could receive a preferential offering prior to a wider offering to the public.

## DEBT FUNDED

7.4 Debt funded solutions are typical of a bank loan or senior lender who would provide debt to the community and repayment would usually start once distributions from the project commence. Debt funding would usually be priced lower than equity as the funder will receive preferential payment ahead of the community. Debt lenders will often stipulate financial covenants on the investment in their terms which could entitle the lender to intervene if any of these covenants are breached in order to protect their investment. It is therefore important to have robust stewardship of the community investment vehicle to ensure these covenants are not breached.

## MEZZANINE DEBT

7.5 Mezzanine debt is a lower ranking, subordinate form of debt and sits between senior debt and equity in terms of seniority. Mezzanine debt is offered by some lenders and will be priced higher than senior debt given the decrease in ranking seniority and provides a quasi-equity return to the lender. Where mezzanine debt is provided, senior lenders will have first rights to repayment, with mezzanine debt getting paid thereafter. Mezzanine debt could be utilised where there is a gap in the capital structure (e.g. senior debt plus community funds is insufficient to meet the entire investment amount) and a mezzanine debt provider could fill this gap to facilitate the investment.

## EQUITY FUNDING

7.6 Equity funding is where the investor will take an equity stake in the communities shared ownership vehicle and adopt equity risk. In an equity funded case, the lender will expect a higher return on their funding given they will be the lowest ranking stakeholder and therefore be exposed to greater risk. In

some cases, the community group will buy-out the investor over time, reducing the investors stake in the community shared ownership vehicle. Equity funded solutions may not be applicable to projects where the returns of the project do not sufficiently exceed the equity returns required by the lender.

## BRIDGE LOANS

7.7 Bridge loans are a short-term form of debt where the lender will provide capital to the community group in order for them to make an investment. A bridge loan would then typically be replaced by a new form of debt in the future with more favourable funding terms. A bridge loan is most common where the community is required to make a quick shared ownership investment but cannot get access to long term debt due to timescales or stage of project development. Bridge loan providers can fund projects quickly so are an option for communities working within tight investment deadlines. Some bridge loan providers can roll a bridge loan into a longer-term debt facility.

# Appendix 3. [Redacted]

QMPF

# Appendix 4. Detailed lending security requirements for each community shared ownership model

| | Joint Venture | Shared Revenue |
|---|---|---|
| Minimum requirements | • Commercially viable project: Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Minority shareholder rights: An equity investor in the Community SPV will have shareholder rights equivalent to their ownership stake percentage in the community vehicle, as per The Companies Act 2006.<br>• Protections in event of sale: In the event that the developer sells the project then the Community would like the option to sell on the same terms, or not and for its rights to the shared investment to continue.<br>• Access to operational performance and project decisions that may impact shareholders return: Equity investors should have regular access to information on their investment which could include operational performance of the project, ongoing operational costs, board meeting notes, operational decisions that may impact investment return etc. | • Commercially viable project: Investment offered at a price which is commercially viable for communities to invest (i.e. a profit will be made above the community's cost of funds)<br>• Protections in event of sale or termination: In the event that the developer sells the project then the Community would like the option to sell on the same terms, or not and for its rights to the shared investment to continue. Termination clauses to protect the community's investment would be sought.<br>• Access to operational performance and project decisions impact the shared revenue agreement: The community funder may require access to regular updates on the operational performance of the project to ensure that the asset was performing in line with valuations. In net revenue models, further details such as operating and maintenance expenses that occur prior to the community's distribution will be required to be disclosed such that the funder can evaluate that expenses are reasonable and not overstated to reduce the distributions paid out to the community and community funder.<br>• Equivalent minority shareholder rights: Contract should include provisions which provide the same level of protection that an equity investor in the Project SPV would have. |
| Likely additional minimum requirements where community needs external funding | • Security over Project SPV shares: The community's funder would usually require security over the Project SPV shares held by the Community SPV.<br>• Step-in rights: The community funder would require step-in rights to the Community SPV in the event of a default on the loan. In such situations the funder would take the community's equity position in the Community SPV and therefore take control of the entity. The community funder may also require a direct agreement with the developer such that in the event of a Community SPV liquidation, existing agreements with the community would be transferred to the community group funder so that they would receive the communities share until the point their debt has been repaid. | • Security over contracted revenue agreement: Community funder would need security over the contracted revenue share agreement such that they would receive these revenues should the Community SPV fail to service its debt repayments. This may be via security being granted over the Community SPV shares.<br>• Step-in rights: The community funder would require step-in rights to the Community SPV in the event of a default on the loan. In such situations the funder may take the community's equity position in the Community SPV and therefore take control of the entity. The community funder would also probably require a direct agreement with the developer such that in the event of a Community SPV default, existing revenue share agreements with the community would be transferred to the community funder so that they would receive the communities remaining agreement until the point their debt has been repaid. |
| Additional aspects that could provide communities with access to more funding options at better rates | • Project SPV board representation: Having board representation in the Project SPV could improve the community's funding terms as the community would have access to more information of the project and potentially the ability to vote on project decisions and influence board decisions.<br>• Security over community benefit income: In cases where the Community SPV also receives the community benefit payment, the community funder may require security over this payment such that they can access these funds should the Community SPV fail to meet debt service payments from the JV dividends.<br>• Minimum return guarantee/loan floor note: If the community group is offered either a minimum return guarantee or a loan floor note, this would be advantageous to its position with a funder as this could be set at a level above the debt service cost which would ensure that the community had sufficient income to meet funder payments, even in times of poor operational performance.<br>• Structural protections in operating contracts: It would add greater certainty to future revenues, and profits, where the operating contracts include minimum levels of performance or availability with associated deductions or compensation being payable where these levels are not met. This could reduce the project, and as such the investment, risk profile and potentially enhance the ability to raise external funds. | • Minimum return guarantee/loan floor note: In a shared revenue model the community does not have shares in the Project SPV so the lender may require either a minimum return guarantee or a loan floor note such would guarantee the funder's debt service costs will be met regardless of operational performance.<br>• Project SPV board representation: Having board representation in the Project SPV could improve the community's funding terms as the community would have the ability to vote on project decisions and influence board decisions. This is of particular importance for a net revenue share agreement where operational/governance decisions directly impact the communities return and consequently the funders.<br>• Security over community benefit income: In cases where the Community SPV also receives the community benefit payment, the community funder will likely require security over this payment such that they can access these funds should the Community SPV fail to meet debt service payments from the shared revenue income.<br>• Structural protections in operating contracts: It would add greater certainty to future revenues, and profits, where the operating contracts include minimum levels of performance or availability with associated deductions or compensation being payable where these levels are not met. This could reduce the project, and as such the investment, risk profile and potentially enhance the ability to raise external funds. |