

To: City Executive Board

Date: 11th June 2014

Report of: Head of Finance

Title of Report: Loan facility to Low Carbon Hub

Summary and Recommendations

Purpose of report: To consider the approval of a loan facility to the Low Carbon Hub (IPS) to facilitate the implementation of a number of renewable energy schemes.

Key decision Yes

Executive lead member: Councillor Ed Turner

Policy Framework: The Council's Corporate Plan

Recommendation(s):

1. That the Board agrees that a fixed term loan facility for the Low Carbon Hub (IPS) be set up capped at £2.3 million on the basis that whenever monies are drawn down from the facility to fund individual renewable energy community projects. The sum drawn down will be repaid with 5% interest following a community share issue for that project, with the potential to revolve the facility to provide funding for other renewable projects in the pipeline.
2. That the potential to revolve the loan facility to provide funding for other renewable projects in the pipeline is built into the agreement subject to the successful repayment of the initial and subsequent loans.
3. That the Board delegates the authority to enter into an appropriate Loan Agreement with the Low Carbon Hub (IPS) to the Section 151 Officer and Monitoring Officer in consultation with the Chief Executive Officer.

Appendices to the report:

Appendix A : Projects to be funded by loan facility

INTRODUCTION

- 1 The Low Carbon Hub (Industrial Provident Society) (" the Hub IPS"), is a not for profit social enterprise that works to lower carbon emissions across Oxfordshire by helping businesses, the public sector and communities to develop renewable energy projects and reduce energy demand. The organisation was set up in

December 2011 and is registered with the Financial Services Authority (FSA) . The IPS has no staff or costs other than maintenance contracts for each generation installation.

- 2 The manpower for implementation and management of the IPS business is supplied under contract from the Low Carbon Hub Community Interest Company ("the CIC"). The CIC is a legal entity registered and regulated at companies house, having a status and structure similar to a company but where the organisation wishes to further social objectives and use their profits for the public good but do not require or who are not eligible for charity status.
- 3 Both the Low Carbon Hub (IPS) and the Low Carbon Hub (CIC) are forms of co-operative and the Councils Executive Director (Community Services) is Oxford City Council's nominee to the Hub Board.
- 4 The Hub partners with local business and the public sector to develop manage and finance renewable energy schemes under a 'Community Benefit Model'. Funding is raised by the Hub and the renewable scheme managed on behalf of a host organisation in return for which the host gets discounted green electricity and CO2 savings.
- 5 The renewable energy scheme is financed by individual Investors in the scheme who receive a return (subject to tax advantages) plus their original investment back and the Hub receives an income from the Governments Feed-in Tariff to invest in further community energy projects.
- 6 Since its inception the Hub (IPS) have undertaken a number of schemes including recently:
 - **Oxford Bus Company** – Installation of 140kW solar pv panels on the bus company roof in Cowley providing the company with low cost electricity, the 10 individual investors a fair rate of return who over a 20 year period receive their capital back plus an average annual interest rate of circa 5% plus tax relief equivalent to 30 % of their investment, and the low Carbon Hub an income stream.
 - **Osney Lock Hydro** – The Hub supported the launch and the marketing of a community owned Hydro scheme in Oxfordshire. The scheme harnesses the power of the Thames to generate 159,000 kWh of renewable electricity. The share offer aimed to raise £250k share equity in a £600k project. The target of £250k was met, 6 days after the launch. As a result the cap was removed and the share offer reached £535.7k of the £600k project.
 - **Westmill Solar Park** – Installation of 5 mw of solar panels located on the Oxfordshire /Wiltshire border spread across 30 acres. It was funded in 2012 by a £6 million share issue from around 1600 shareholders who have a share in how the co-operative is run and benefit from the project revenues.

PROJECTS IN PIPELINE

- 7 The Hub has a pipeline of renewable projects to build, own and operate renewable energy power generation facilities in Oxfordshire (typically solar PV and hydro). The schemes for which the Hub is seeking funding involve the installation of solar panels on the roofs of host organisations, namely schools and local businesses. In return the host will obtain discounted electricity.
- 8 Projects currently ready for installation this Summer are included at Appendix A with a summary provided below :

Projects to be funded by Loan Facility		
	CAPACITY	INSTALLATION COST
	KWp	£000's
Solar panels for schools	1,266	1,725
Solar panels on businesses	375	457
Total value of schemes	1,641	2,182

- 9 It is worth noting that of the 25 school installation only 3 are in the City boundaries and neither of the two businesses are in the city.

Pipeline Projects

- 10 There are a number of projects still under development in the pipeline which will not be ready until 2015 and would form part of a potential second 'revolving' of the loan facility. These are listed below

Projects in Pipeline		
	CAPACITY	INSTALLATION COST
	KWp	£000's
Solar panels for businesses		
Lucy Lighting	250	n/a
Polestar	618	n/a
Barry Callebaut	700	n/a
Chris Hayter	250	n/a
London Oxford Airport	250	n/a
Unipart	377	n/a
Bicester Garden Centre	250	n/a
Norbar Tools	700	n/a
Seacourt Park and Ride	500	n/a
Total businesses	3,895	n/a
Sandford Lock Hydro	440	4,000

Total pipeline schemes	4,335	?

Loan Facility

11 The Hub has two difficulties in securing the pipeline projects :

- It needs to be able to move quickly to build projects
- Part of the construction facility is in respect of loans to businesses who are not enthused by having to wait while the Hub raises money on a project by project basis.
- The majority of this loan facility is to install pv solar panels on school roofs which would be more easily undertaken out of term time and hence there is a window of opportunity to undertake the work.
- The Hub is looking to undertake a share launch in September /October. Apart from capacity issues the Hub does not want to issue the share issue before this because:
 - a. the limit on single investments into community benefit organisations goes up from £20k to £100k as of 1st July this year;
 - b. new legislation comes into force on 1st August this year which requires existing Industrial and Provident Societies to choose a new structure becoming either an IPS for community benefit or an IPS co-operative, this will require a change in company structure:
 - c. changes announced in the budget to the Enterprise Investment Schemes tax relief rules mean that only Community Benefit IP Societies can obtain get the combination of EIS and FITs
 - d. Since the above changes are implemented in Summer it is considered that this is not a good time to undertake a share issue

12 The Hub is therefore seeking to establish a loan facility with the City Council whereby it can start construction of projects immediately following signature of the lease with the host. Once the project has been built it will then be refinanced using equity, in the form of a share issue as highlighted in the Osney Lock Hydro Scheme above. The Hub want the construction facility to revolve for a period of three years so that once repaid by the equity issue it is available to finance other projects.

13 Key principles of the proposal are:

- a. Low Carbon Hub engage host organisation and contract with Government for Feed-In Tariff.
- b. Feed in tariff is pre-registered and for small installations of below 50kWp fixed up until March 2015 and for installation > 50kWp is guaranteed for 6 months until end of September 2014 after which it is index linked for the next 20 years.
- c. Low Carbon Hub engage with supplier to install the solar panels
- d. 'revolving' loan facility of up to an estimated £2.3million is drawn down as required to procure and install the PV panel
- e. Following construction the Hub will seek to re-finance the procurement and installation costs (the loan) through the issue of shares to investors in the

community. The cycle length would be 6-9 months with interest payable on repayment of the funds to the Council

- a. There is an option to revolve the loan facility for up to three years with a break clause for either party at the end of reach 'revolution' for each party to evaluate the success of the scheme.
- b. The Council will receive a 5% annual rate of return on drawn down funds. Equity investors would get 5-7% plus a tax break and their capital back, the building owner gets a discount on the energy it buys from the Hub. There is a community benefit donation from the Hub to the CIC equivalent to an annual equivalent of around 3% of the total construction cost.
- c. £500k of the 'community benefit' to the Hub (CIC) will be directly invested on renewable energy schemes within Oxford City.
- d. There will be no change to the schemes to be funded by the loan facility unless approved by the Council

Financial Implications

- 14 The proposed drawdown of the loan from the Council is in accordance with the contract payments to the supplier for installation of the equipment which is currently estimated to be :

Estimated Cash Flows – 2014							
	June	July	Aug	Sept	Oct	Nov	Total
	£000's	£000's	£000's	£000's	£000's	£000's	£000's
Panels	35	353	340	108	0		836
Inverters	10	94	91	29	0		223
Schools				634	0	149	782
Businesses			191	83	0		274
Pre Development				184	0		184
Total	45	446	622	1,038	0	149	2300
Share issue repayment						(2,300)	(2,300)
Estimated interest receivable						(34)	(34)

- 16 The cash flows are estimated and will vary according to the contact payments to the supplier although the whole cycle should the share issue be successful should be no longer 6 months between the first payment to the Hub and repayment of the principle sum to the Council

- 17 The Council currently earns an average of 0.89% on its investments. The proposed loan to Low Carbon Hub will have a return of 5%. The Loan is short term and therefore not classed as capital expenditure and hence does not require a capital budget or capital funding as the loan is simply repaid with the proceeds from the share offer within the financial year. Should the share offer not provide sufficient funds then the situation will need to be reassessed (see paragraph 23

below around risk). The amount of interest accruing to the Council as a result of the transaction amounts to around £34k and is therefore negligible relative to the £500k budgeted annual investment returns of the Council.

- 18 In entering into the proposed loan arrangement, the Council can rely on the general power of competence created by s1 Localism Act 2011. This allows the Council to “do anything that individuals generally may do”, and thus would provide authorisation for the making of a loan of this nature. In addition, making the loan would help to facilitate the Council’s compliance with its IEE OxFutures contractual obligations, in regard to generating the required investment gearing from the IEE grant funds received
- 19 The Hub is contracted by the City Council and County Council to deliver the Intelligent Energy Europe grant funded OxFutures programme. The value of the contract from the City Council is £600k over three years to November 2015. This includes a co-funding element which is met by the grant funding for the Low Carbon Hub to provide programme management services for the Low Carbon Oxford (LCO) partnership. Low Carbon Oxford grant funding is £50k in 2014-15 and no further funding is planned for 2015-16. The Hub also receives additional funding from the County Council for LCO projects and other funding secured from external investors.
- 20 The IEE grant funded OxFutures programme is required to raise a minimum of c. £20m investment in energy projects in Oxfordshire by the end Nov 2015. If the minimum investment target is not met, there is a possibility of claw back of part of the grant by the European Union. The Hub’s pipeline of projects, which will be financed through the loan facility, will contribute to meeting that target.

Legal Implications

- 21 The key provisions of the loan agreement will be those which seek to provide the Council with adequate security to protect its funds. These will include a requirement that all loans be repaid immediately funds are received from scheme investors. If the funds received prove to be insufficient and the Hub is unable to fund the repayment, the Council will need to protect its interests in different ways. These are set out in more detail below, but in summary these would be either through the Council taking ownership of the relevant scheme equipment (eg the PV solar panels) and/or through obtaining rights to the FIT income generated. by the scheme. Consideration will also have to be given to the potential failure of the Low Carbon Hub IPS itself at a point when monies are outstanding. Again this is considered below. These measures will reduce, but cannot entirely eliminate, the risk arising under the loan facility proposal.
- 22 Most of the proposed scheme projects are located outside the city boundary, but should the City Executive Board wish to pursue this matter the general power of competence should enable the Council to provide this loan facility.

Risk Implications

Failure of the equity share scheme to raise sufficient funds

- 23 The Hub are seeking to target High Net Worth investors to take up the share issue although the raising of the £2.3 million funds through this mechanism still

represents the greatest risk to the project. -In this event the agreement will allow for :

- A 3 month 'period of grace' from the agreed date of repayment by the Hub to the Council to give the opportunity for the Hub to raise alternative funds either from the Charity Bank or private financiers who the Hub are currently in discussion with.
- In the event of a default after the '3 month period of grace' the agreement would allow for the following :
 - The creation of a Floating charge over any of the Hub's assets (which would then have to be converted into a fixed charge over defined assets such as the panels)
 - Assignment rights over the assets and the contracts
 - Step in rights to intervene in the business to ensure that the appropriate steps are taken to secure the project as a going concern and thus maximise the value of the security, although it is recognised that this is something of a last resort and is not something that the Council would prefer to do.

Failure of the contractor employed by the Hub

24 The Hub (IPS) has procured a solar panel installation contractor who has also been responsible for the design of the solar panel installations. Whilst the failure of the contractor is to some extent a matter for the Hub (IPS), since the contract is with them, there may be cost implications which may indirectly affect the Council. An independent Financial Check undertaken by the Council has however shown that the financial strength of the contractor is not strong and the credit rating is low, although it is acknowledged that this financial standing may not be untypical for contractor operating in this industry. Mitigations against the failure of the contractor include:

- The contract between the Hub and the contractor would allow for the purchase of the solar panels (equivalent to approximately 50% of the contract price) directly from the solar panel supplier with the panels being subsequently owned by the Low Carbon Hub (Industrial Provident Society)
- Normal contract terms apply with a retention held for the defects liability period of 6 months
- The contractor will provide a 2 year corporate warranty on the installation.
- Original Equipment Manufacturer (OEM) guarantees will be provided for 5yrs for inverters, 10 years for panels and 25 year for panel performance
- No money is paid to the installers for installation of the panels until the system is signed off accredited Microgeneration Certificate organisations, which subsequently grants the eligibility to claim the Feed In Tariff.
- If planned well the installations are simple to fit

Financial Failure of the Low Carbon Hub (IPS)

25 The Hub intends to structure the solar panel installation contracts such that the first payment to the supplier is for the purchase of the solar panel units. Whilst the loan from the Council would be unsecured the Councils agreement with the low Carbon Hub would provide for :

- The creation of a Floating charge over any of the Hub's assets (which would then have to be converted into a fixed charge over defined assets such as the panels)
 - Assignment rights over the assets and the contracts
 - Step in rights to intervene in the business to ensure that the appropriate steps are taken to secure the project as a going concern and thus maximise the value of the security, although it is recognised that this is something of a last resort and is not something that the Council would prefer to do.
- 26 The Council's potential financial loss is also mitigated by the stage payments to the Low Carbon Hub based on the value of work done by the contractor, although it should be noted that there is some increase in administration costs for the Council.

Rising Installation Prices

- 27 The price for the installation has been fixed with the installer and therefore any rise in price and hence any requirement to increase the loan from the Council should not occur.

Conclusion

- 28 The Low Carbon Hub (IPS) have an impressive track record of enabling the implementation of a number of renewable energy schemes, via share issues which make a decent rate of return for the host and the investor whilst reducing carbon emissions and improving the community.
- 29 The £2.3 million loan to the Low Carbon Hub (IPS) would be a short term commercial loan facility with a fixed rate of return of 5% with repayment of the principal plus interest via a share issue in September /October. The amount of accrued interest to the Council will be in the order of £33k. The transaction is not a typical one for the Council in comparison to the normal investment deals that it would make under its Treasury Management Strategy where the amount of interest and return date is certain. Whilst a 5% rate of return is currently favourable compared to interest earned from alternative investments, interest rates are forecast to rise in October 2015 and holding fixed interest 'investments' long term does expose the Council to some degree.
- 30 The main risk to the granting of the loan would be that the share issue does not secure sufficient investment to repay the Council. Despite an impressive track record of raising finances from this vehicle by the Hub on other projects, past experience is not necessarily an indicator of what will happen in the future. The Council or the Hub has limited control of what will happen. Whilst there are some mechanisms to enable the Council to seek repayment of its loan via other routes, for instance selling the debt, these mechanisms are not straightforward. Should members wish to proceed with the loan facility then the Council will agree measures to ensure as far as possible the security of its investment through the Heads of Terms.

- 31 The financial case is not strong since the return in cash terms is minimal, (£33k) for the increased risks taken on, the greatest of which is the failure of the share issue to enable the return of the Councils loan in the specified period. In making a decision Members need to consider this against the benefit to the Community of Oxford and Oxfordshire at large in facilitating the renewable energy community projects.

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List of background papers: None

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