

Energy and Climate Change Brief

Summer 2011



In this issue

Meet the team

News briefing

Green leases: What they mean for
landlords and tenants

Great idea for an energy business?
What else is needed

Q&A: Feed-in Tariffs and grants

2

2

4

6

8

Welcome

Welcome to the first edition of the Energy Brief which is brought to you by the Devonshires' Energy and Climate Change Team. For those of you that have not come across us already, we are a multi-disciplinary team bringing together experience from projects, corporate, property, procurement and finance to deliver expert advice on energy and climate change related matters.

In this brief we aim to bring you the latest developments in the energy sector, including legislation updates and case studies.

We hope you enjoy the first edition.

Meet the team



Each edition of the brief will focus on a different member of our Energy and Climate Change Team. We start in this first edition with Partner Paul Buckland.

Paul is Head of our Energy and Climate Change Team and he also leads the Projects Group. His current focus is on renewables within the public and housing sectors and he is currently acting on a number of projects involving the installation of solar panels in social housing. These include both self funded and third party "rent a roof" schemes. He is also advising in relation to Community Energy Saving Programme and Carbon Emissions Reduction Target Programme projects and is speaking to a number of clients about the roll out of the Renewable Heat Incentive and the application of the Green Deal into social infrastructure.

Paul is the lead Partner involved in the development of Devonshires Energy and Climate Change Team and has developed innovative relationships with ECD Architects who are major players in the social housing sector. Paul frequently runs seminars that address issues that are important to the sector including funding for energy, Renewable Heat Incentive and Feed-in Tariffs.



News briefing

The energy sector is fast paced with a number of government initiated schemes up and running and many more in development. Here is the latest news on recent developments:

The Renewable Heat Incentive (RHI)

The regulations which underpin this scheme remain on track to be approved by Parliament within the next few months and the introduction of the first phase of the RHI for the non-domestic sector should follow shortly after. An announcement is expected soon and will hopefully provide further details of the £15m interim scheme for residential installations which comes under the first phase. It is still intended that the introduction of the second phase, allowing households to benefit from the RHI, will coincide with the introduction of the Green Deal in October 2012. For a more in-depth explanation of the RHI, please see our Dbulletin 'Uk Government launches the Renewable Heat Incentive (RHI) scheme' on the Energy and Climate Change page of our website.

Green Deal

The Green Deal is the flagship policy in the Energy Bill which is currently making its way through Parliament. The Green Deal will allow private firms to offer consumers energy efficiency improvements to their homes, community spaces and businesses at no up-front cost. The cost of these improvements will be met by recouping payments through a charge (linked to the property rather than the individual) collected by instalments which will show on the consumer's energy bill. Consumers will be able to see the Green Deal charge alongside the reductions in energy use which generate savings on their bill. The expected financial savings must be equal to or greater than the costs attached to the energy bill. This is known as the golden rule of the Green Deal. At present, the secondary legislation in relation to the Green Deal is being developed, and it is anticipated that the first Green Deals will appear in October 2012.



Further proposals under the Green Deal in relation to landlords were outlined at the second reading of the Energy Bill in Parliament on 11 May 2011. It is proposed that from 2016, any tenant asking for their landlord's consent to make reasonable energy efficiency improvements cannot be refused, and from 2018 the rental of properties with an energy efficiency rating of F or G will be banned through a minimum energy efficiency standard.

Feed-in Tariffs Review

On 9 June 2011 the department for Energy and Climate Change (DECC) confirmed the outcome of their fast track review on Feed-in Tariff (FIT) levels of support for large scale solar and anaerobic digestion installations. From the 1 August 2011 a new tariff will see generators of over 50kW receive a significantly reduced payment per kW. The review came about in order to meet spending review targets amidst a higher than expected deployment of larger scale solar photovoltaic (PV) and evidence of significant reductions in the costs of PV since the introduction of the FIT. By introducing the new tariff, DECC is aiming to protect the money available for small scale projects that benefit householders, small businesses and communities. Accordingly, microgeneration of up to and including 50kW was not within the scope of the review and these tariffs are unaffected.

“From 1 August 2011 a new tariff will see generators of over 50kW receive a significantly reduced payment per kW.”

Green Investment Bank

The Green Investment Bank (GIB) is set to launch in 2012 with the aim of providing organisations with the financing they need for clean energy projects (that commercial lenders would be reluctant to fund), in order to help the UK make the transition to a low-carbon society. In his recent budget, George Osborne committed to capitalising the GIB with an extra £2bn worth of funding on top of the £1bn already pledged and allowing the GIB to borrow money from 2015. It is hoped that the GIB will facilitate an additional £15bn worth of private sector investment in green projects by 2015.



Green leases: What they mean for landlords and tenants

Green leases which have been used for a considerable time in other jurisdictions - particularly Australia - are at last gathering some support in the UK.

The basic idea behind a green lease is that the landlord and the tenant co-operate with each other to reduce the carbon output of the premises that is the subject of the Lease, and try to promote other sustainability initiatives.

Green leases at present apply only to commercial premises and have at the heart not only environmental issues but also the desire of both landlord and tenant to run the building as economically as possible. Whilst green leases have been popular in Australia for some time and actively promoted by the Government, landlords and tenants in the UK have been relatively slow to embrace green leases. However, the CRC Energy Efficiency Scheme which came into force in April 2010 making the CRC applicable to larger organisations has given a boost to green leases. It is expected that, as the CRC applies to more and

are Section 417 of the Companies Act 2006 which requires “companies to include information about environmental matters in their annual business reviews where this is relevant to understanding the company’s business”, and the Climate Change Act 2008, which contains (in sections 83, 83 and 85) provisions by which the Government must make regulations by 6th April 2012, requiring mandatory corporate carbon reporting.

Energy Performance Certificates (EPCs) are now required whenever commercial premises are offered for sale or lease. These will also provide an impetus to greater energy efficiency generally.

In the absence of any specific Government requirements relating to green leases, private landlords such as Hermes and Land Securities have been promoting them, CRBE has published a guide to incorporating environmental best practice into commercial lease agreements, and the Better Buildings Partnership (BPP) has published its Green Lease Toolkit. The BPP has also published notes which recommend the use of a Memorandum of

“In practice, a wide range of green leases are in use, with a variety of formats.”

4

more commercial organisations, green leases will become more popular as people look for ways of reducing their CO2 emissions.

However, there are other reasons why landlords and tenants may both wish to use green leases. Examples include:

- Compliance with Corporate Social Responsibility policies
- To future proof the building
- To achieve greater energy efficiency and comply with requirements of new and refurbished buildings
- Compliance with statutory requirements
- Compliance with the Government's public procurement requirements

Some of these objectives are self explanatory. An important driver that is becoming more common is for companies to be required to report on environmental issues. Two recent developments

Understanding between landlords and tenants in relation to environmental matters rather than a specially drafted green lease.

In practice, a wide range of green leases are in use, with a variety of formats. Even without any formal documentation, it is common now for landlords and tenants to work together to reduce energy consumption and achieve other environmentally desirable aims, such as dealing better with waste recycling, cutting water use, and providing facilities which encourage green transport, such as bike racks and showers for cyclists.

The least formal type of documentation will be a simple Memorandum of Understanding which might be agreed and amended from time to time. A model form of Memorandum of Understanding is available online from the Better Buildings Partnership website (www.betterbuildingspartnership.co.uk/.../green-lease-toolkit). One of the first things to consider is to

do with data sharing. If the aim of the parties is to reduce energy and consumption and waste generation, there must be some benchmark against which to measure the hoped for improvement in performance. The memorandum also deals with setting up a building management committee with representatives of the landlord, tenant and any managing agent involved with the building, to work together to improve the environmental performance of the building.

The schedule contains a number of initiatives to be undertaken in relation to energy, waste, water, energy audit, alterations and replacement, transport, cleaning etc. The same website also has draft green lease clauses to go in a new lease or a renewal under part 2 of the Landlord and Tenant Act 1954.

The model lease clauses cover material similar to that dealt with by the memorandum of understanding, but here the obligations are meant to endure for the term of the lease and the binding on the parties.

in April 2009, and in June 2010 an article was published in Estates Gazette reporting on uptake. Not surprisingly, uptake was strongest amongst public sector tenants, with retailers being the most resistant to signing a green lease or Memorandum of Understanding. The Memorandum of Understanding was generally used rather than green lease clauses, and it was felt that the recession could have resulted in a reluctance of people to investigate green leases, even though considering green issues would probably result in savings at least to the tenant. The article reported that apart from a core group of landlords who actively promote green leases, many people in the property industry still did not know about green leases or how to create one.

As the CRC starts to bite, this will undoubtedly change.

For further information please contact:

Susan Hall on 020 7880 4261 or
susan.hall@devonshires.co.uk

“One obvious barrier to the uptake of green leases is the question of cost.”

5

One obvious barrier to the uptake of green leases is the question of cost. Generally speaking it will be for the landlord to pay for improvements to a building, whereas the tenant will get the benefit in terms of a more pleasant working environment and lower energy bills. The obvious solution is to adopt a fairly conservative approach and introduce only low cost initiatives. However a landlord may be persuaded to spend significant costs on upgrading the building if it is able to get vacant possession of at least part on the basis that the building will become more attractive to potential tenants. As higher energy efficiency standards are imposed in relation to new buildings, older buildings will become less attractive to tenants. Thus expenditure on green issues may be seen by landlords as future proofing the building and preserving its value.

The model Memorandum of Understanding and Memorandum of Lease were introduced



Great idea for an energy business? What you need to know

Introduction

Establishing any new business is a daunting prospect. Start ups are notoriously difficult to make a success but good planning will often get you a long way. The energy and climate change sector, in particular, has seen more than its fair share of new ventures that have been born from a new idea, new technology or a new demand.

An idea is one thing, however making it work is entirely another. We have heard the phrase a number of times “it is not about the product” but more about the way in which it is developed, enhanced, brought to market and the quality of the team that is involved. Here below are some of the more important things you need to consider when starting a new business - no matter what size or complexity.

The Team

The importance of getting the team right is underestimated as it is central to the perceived and actual success of the venture. Funders will look

money back on a tax neutral basis as possible and so the use of loan notes and redeemable preference shares are common. Investors will also want to structure the deal in the most advantageous fashion for themselves. The owner or manager will need advice on the value of the new venture and the cost of their own strip of equity.

Intellectual property

Do you fully understand which type of intellectual property you have and use in your business? Copyright, trade marks, patents and design rights are all used in different ways. You will need to make sure that you own or have the right to use the intellectual property that is important to your business. Investors will want to see intellectual property protected by registration if appropriate and other trade secrets also protected.

Infrastructure

What is needed to put the project on the map? Different stages and different skills will be necessary to ensure development is carried

“The energy/climate change sector, in particular, has seen more than its fair share of new ventures...”

6

closely at whether the right people are in the key roles such as CEO, finance director and sales/marketing director. Non executive directors also are important to provide independence and market expertise. Founders and how they are to be treated will need careful thought to enable flexibility to be built into the model.

Finance: Debt v Equity

The first decision to make is whether debt finance from primary lenders is an option. Often with new ventures it will not be, therefore equity, or quasi-equity will need to be arranged from institutions, corporations or high net worth individuals. A number of structures use convertible loan notes (secured or unsecured) which can be swapped into ordinary shares upon reaching certain milestones. This gives the investor some confidence and control if the plan doesn't work out.

Tax planning is important when determining the route to funding. Investors will want to get as much

out to plan. The correct number of contractors and employees should be used, the right level of computer and software support, the network of suppliers built etc. Putting in place the infrastructure once the funding has been obtained so is key to the success of the project.

Share structure

Often this is left to the last minute since it requires input from all sides including initial valuation of the venture (which can be tricky since at that point there may not be any profits or revenue) and the percentage of equity that will be provided to the investors. This can be an interesting conversation based on discounted cash flows and arbitrary discounts. Once determined comes the task of working out the share capitalisation to ensure that the initial pricing, nominal value, share premium and number of shares in issue, all fit together with a view to producing an incrementally increasing share price. We would suggest some FD or accounting support at this stage.

Fundraising documents

The fundraising documents and contents will be prescribed for entities that are choosing to list on a recognised exchange. However companies not offering shares to the public have carte blanche to fill the contents of the fundraising documents as they see fit. Whilst some companies seek to provide a small amount of information and ask investors to rely on their own due diligence, others (particularly when seeking equity from private clients) will need to produce documents to a similar standard to those produced by public companies so that investor confidence is met.

Putting valuations and projected cash flows, profit and loss and balance sheets into fundraising documents is not a good idea. Presenting this information and determining the fundraising process (treading carefully through the regulatory minefields) needs to be thought through carefully based on who is involved and how it is intended to occur in practice.

change matters, now is an opportune time to get involved in the greening Government-backed programmes and funding, both already in existence and in the pipeline (CRC, FiT, RHI and the Green Deal). In an otherwise bleak economic climate this sector is taking off at a fast pace, making this an ideal time to strike your own “green deal”.

All new ventures are different and whilst the issues may be similar, the outcomes after discussion will undoubtedly be bespoke and geared towards the business being developed. Working out strategy and implementation plans are paramount to the business' success which brings us back full circle... When establishing a new venture, planning (and the right advice) is crucial to its success.

For further information please contact:

Jonathan Ebsworth on 020 7065 1867 or jonathan.ebsworth@devonshires.co.uk

Caroline Mostowfi on 020 7065 1855 or caroline.mostowfi@devonshires.co.uk

“In an otherwise bleak economic climate this sector is taking off at a fast pace, making this an ideal time to strike your own “green deal”.”

7

Seed capital

Generally putting together the team, the initial infrastructure and the fundraising documents will require the engagement of a professional team even if the management have done this a number of times before. All of this costs money and unless you have a clear route to the target fundraising amount, it is unlikely that all this will get carried out without a certain level of initial costs or risk on the part of the promoters of the new business. Seed capital therefore is important to get for the company and could come from the management team themselves, friends or family. A cornerstone investor is also important and may even be persuaded to put up some of the seed capital to get the venture going in the first instance.

Conclusion

With the UK Government having never been so committed to tackling energy supply and climate



Q&A: Feed-in Tariffs and grants

Since the introduction of the Feed-in Tariff (FIT) scheme in April last year, there has been some confusion surrounding the relationship between obtaining public funding and claiming under the FIT.

I am a registered provider in receipt of public funding and I am also looking to install solar panels on some of my housing stock and claim Feed-in Tariffs. Is this possible?

If the solar panels are funded by public funding/grant you may not also be entitled to claim the Feed-in Tariff as this could be considered prohibited state aid.

Is there any guidance available to registered providers?

In March, the Homes and Communities Agency (HCA) published a statement on Feed-in Tariffs and HCA funding, produced in conjunction with the Department for Communities and Local Government (DCLG) and the Department for Energy and Climate Change (DECC). You may also require bespoke legal advice.

than the standardised costs on which the FITs are calculated.

The final circumstance is where the generator is in compliance with the EC's rules on de minimis aid. To comply with these rules, the public grant plus the FIT payment a generator receives must not exceed 200,000 euros over a period of three years.

If I can't benefit from the FIT then I won't install the solar panels. Will I still be able to meet Code for Sustainable Homes (CSH) level 3?

The HCA, DCLG and DECC consider that compliance with CSH level 3 energy performance standard can generally be met through fabric efficiency measures and the ability to meet this standard does not automatically or absolutely require renewable measures to be installed.

Can I benefit from the FIT if a project is grant funded but the element of the grant relating to the installation is repaid?

Yes. You could also utilise both grant funding and

Edited by: Paul Buckland and Caroline Mostowfi

Head Office: 30 Finsbury Circus, London EC2M 7DT

Further copies: Marketing Department on t: 020 7628 7576, or email info@devonshires.co.uk or via our website at www.devonshires.com

Devonshires has taken all reasonable precautions to ensure that information contained in this document is materially accurate however this document is not intended to be legally comprehensive and therefore no action should be taken on matters covered in this document without taking full legal advice.

What does the guidance advise?

If a generator wishes to receive FIT payments, they must give notice to Ofgem that no grant has been made in respect of any of the costs of purchasing or installing the installation or where any such grant has been made. It has since been repaid.

It is not possible for a generator to benefit from both FITs and a grant from a public body except in specific circumstances.

Can you tell me more about these specific circumstances?

A generator may be able to benefit from the FIT where a grant is a "permitted grant", i.e. made before 1 April 2010 in respect of costs of an installation commissioned before 15 July 2009 or for a residential property commissioned between 15 July 2009 and 31 March 2010.

Funding and FIT payments may also be allowed if the cost for an installation is significantly greater

receive the benefit of the FIT if there is a clear distinction between the use of the grant funding and the installation receiving the FIT. This could be achieved if grant funding was used to construct the units (i.e. excluding the solar installations), but private funding was used to purchase and install the installation which could then be eligible for the FIT.

To what extent can I rely on the HCA/DCLG/DECC guidance?

The guidance is just that and Ofgem have not confirmed it. Ofgem will need to be convinced on a case by case basis as there is no pre-accreditation process for FITs eligibility will only be confirmed in response to submission of an application.

If you'd like advice on eligibility to claim FIT, please contact:

Caroline Mostowfi on 020 7065 1855 or caroline.mostowfi@devonshires.co.uk