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Community Energy: *Unlocking Finance and Investment – **The Way Ahead***

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This publication is a snapshot of a private roundtable discussion, held on 13th March 2014, which drew together a range of leading thinkers to explore how finance and investment for community energy can be unlocked. Pushing beyond where the discussion ended, it concludes with a note which charts the 'Way Ahead'.[1]

Introduction

Soaring utility bills and plummeting trust in the UK's energy industry has forced an urgent re-think of what we want our energy market to look like and be. We need a market that provides a public good for the benefit of society, and which enables communities, individuals and our economy to flourish. We need a market which, while achieving such ends, drives down household bills, opens up opportunities for greater participation and provides a platform for social and entrepreneurial innovation.

One growing opportunity, which has already kick-started such a revolution in the UK, is community energy. In this paper, we use the term 'community energy' to refer to community-owned, governed or invested power generation projects, of any type or technology. We also advocate a more holistic approach and understanding of what it means for communities and individuals to participate in the UK's energy market. Opportunities should be open to communities to not only govern, but to own and invest in small and medium-sized businesses involved across the supply chain – from generation to supply.

We have witnessed a rapid growth in the number and capacity of community energy projects over the past few years, particularly in the renewable sector. As of January 2014, there was 66MW of installed community renewable electricity capacity, and over 200MW in development.[2] This represents just 0.4% of the UK's total renewable energy capacity, but community energy has the potential to grow even further. As ResPublica's *Community Renewables Economy* report highlights, the sector could grow 89 times this size, with the right infrastructure and support.[3]

Alongside the planning process, one of the other major hurdles to the starting up and scaling up of community energy is access to finance. In addition to immediate fixes and recommendations for policy, the group agreed that the long-term key to boosting investment in and income streams for such projects will be in further embedding community energy in the way in which we generate and supply our power, and in 'humanising' energy – making it more tangible and accessible – in order to engage a much broader group of people. Keys to unlocking such access to both the market and wider society include harnessing the growing micro-investment and crowdfunding market, which has boomed in recent years. Ensuring that tax relief structures and other incentives are constructed to tap into this emerging opportunity – for both investors and community energy – is crucial. The SME lending environment and regulation of alternative finance were also raised as both central barriers and opportunities for wholesale reform, which can and do impact significantly on the way in which community groups and small businesses raise and attract capital.

1 Please see the End Note for the full list of participants.
2 Capener P. (2014) *Community Renewable Electricity Generation: Potential sector growth to 2020: methodology, detailed assumptions and summary of results*, Department of Energy and Climate Change.
3 Harnmeijer J., Parsons M., and Julian C. (2013) *The Community Renewables Economy: Starting up, scaling up and spinning out*, London: ResPublica. Available at: http://www.respublica.org.uk/documents/yqq_Community%20Renewables%20Economy.pdf.

The Vision

Fundamentally, we need an energy market that works. Uncontrollable market forces and the cost of living crisis have left many powerless to respond to rising energy bills. Currently, our energy market is failing both our economy and our society. Wholesale reforms are in demand, and new ways to engage with consumers and communities in their energy provision and use are urgently needed.

Key to achieving such outcomes will be engaging wider society. This must involve enabling market entry for individuals and communities, and opening up the opportunity for people to meaningfully participate in every point of production and use. Community energy and community asset ownership has brokered many communities into a market that has previously excluded them. This now needs to be mainstreamed, supported and properly integrated into local economies and wider energy and financial markets in order to achieve the outcomes that we need.

This will require a policy framework which works to eradicate the barriers faced by individuals and communities in starting up and growing, and which offers the appropriate infrastructure and incentives for community energy to tap into new opportunities for finance and growth. Boosting the capacity, supply and appeal of such projects will be crucial to embedding it further into the UK's energy market.

Such outcomes will also require a transformation of demand. Community energy projects – where community groups or co-operatives own and generate electricity and/or heat – should not be perceived as a parochial adjunct to mainstream power, but as a key ingredient to our energy mix. Participation, community ownership and the growth of SMEs are crucial to the success of our energy market. With heightened concerns regarding competition, the cost of living and dwindling levels of trust, such principles must now become the norm rather than the exception.

The money is there, and the infrastructure is possible – the question is how to realise it.

The Problem

Seen as a parochial adjunct to mainstream power, community energy has not successfully been integrated into the mainstream supply chain, and the majority of attempts to finance and encourage investment in community energy projects offer piecemeal rather than wholesale change. The headline barriers to greater finance and investment for community energy emerge from its current exclusion from the wider system, and perception on the part of policy-makers and investors that the sector is niche, vague and intangible. Until community energy is in significant demand, it will always lack the attention needed from investors, private and public partners, and the wider population.

Aside from this overarching concern, there are significant supply-side issues. Numerous communities and individuals struggle to find the right resources to start up and grow their business. Reviewing the barriers that prevent greater funding and investment opportunities for new and existing community energy projects is therefore crucial. The group highlighted a series of typical hurdles, which can be grouped under the following three areas: the nature of community energy; investor concerns; and regulation.

The nature of community energy

Engaging, values-driven, local and profitable: the nature of community energy has in many respects contributed toward its significant and growing success. But for some, it can present a series of difficulties. Many of the barriers faced by community energy groups are those inherent to start-up businesses: entrepreneurs can lack the relevant experience; the business itself can lack the equity needed to absorb risk or cover traditional risk mitigation; and start-ups often start out with no balance sheet or track record. Two-thirds of small and medium sized enterprises (SMEs) fail within the first year of starting up, and community energy groups are susceptible to the same risks.[4] These are small enterprises, incurring high set-up and transaction costs with little room for economies of scale.

4 Jaffa M. and Cave A. (2010) *Vision for a National Mentoring System: Connecting business owners with business mentors*. London: The Federation of Small Businesses.

Such businesses are also heavily reliant on volunteers, which while fundamental to the success of many existing groups, can bring its own risks and present its own barriers. Particular skills, documentation and external advice are often needed, as well as the necessary business knowledge such as awareness of the appropriate legal models and financial and investment terrain. We have seen the emergence and success of a range of knowledge transfer outlets – Energy 4 All, Resilience, Pure Leapfrog, the Community Energy Association and the Department of Energy and Climate Change's new Community Energy Unit and 'One Stop Shop' information resource, to name just a few – but greater support mechanisms need to be put in place.

These hurdles are exacerbated by factors specific to energy generation and the energy policy landscape. The technology used by the groups has a long lead-time, with a modest rate of return for a prolonged period. Gaps in development funding in the pre-construction period, for example, can be fatal for purchasing the necessary technology. Funding must be guaranteed in order for such groups to procure resources. Linked to this, a lack of policy stability and dependence on green subsidies are a barrier to attracting finance and investment for larger renewable energy companies, let alone small community groups.

Investor concerns

The lack of integration of and demand for community energy in mainstream markets means that investors lack confidence in the probability of a return on their investment. Without the incentive of a good rate of return 'at scale', investors are often unwilling to put their faith and, more importantly, their money, into the hands of community energy groups.

This reticence partly stems from a lack of understanding. The heterogeneity of the community energy market and the nature of voluntary leadership can be off-putting for investors, as the relative merits are hard to assess. It is difficult for investors to determine, for example, if those running such groups will persevere if the project was to face significant hurdles or be as committed to its success as they need to be. The leadership of community energy groups may also not have any previous or relevant business experience, leading to the perception on the part of investors that they may not be suitable to take on debt.

The multitude of business structures that community energy groups can adopt provides an additional hurdle: investors can find it hard to judge which model offers the greatest likelihood of a reasonable rate of return. This problem is compounded by a lack of belief in the financial sector that community energy will ever be large enough to justify the effort and resources needed to learn about such models in more detail. It can be hard for community groups to convince investors that they provide a profitable opportunity: banks and other companies cannot use their standard risk assessment to price the effects of community involvement and individual investors struggle to obtain financial advice with sufficient understanding of the different models, resulting in reluctance to finance these projects. This severely limits the access of community energy to retail funding, cutting them off from a key SME resource.

These serious gaps in perception and understanding are injurious to the prospects of investment in and lending to communities. Even the natural allies of community energy – the worlds of renewable investment and social investment – do not yet communicate or co-ordinate in a way which ultimately leads to adequate support of such ventures.

Regulation

Investor concerns have generated – and have in turn been reinforced by – a culture of regulation which has emphasised high investment risk and the need for risk protection. New and successful methods of investing in and lending to community and local energy projects have emerged through peer-to-peer lending and crowdfunding, but such platforms have suffered as a result of being new, small and different. The Financial Conduct Authority (FCA) has thus far been slow to regulate this emerging industry. Indeed, the introduction of regulation came about as a result of direct lobbying from crowdfunding platforms, who were heavily involved in the creation and implementation of legislation – which became effective as of April 2014.

The FCA is, in general, perceived as a serious barrier to enabling communities to raise and borrow capital from a diverse range of sources. The regulator tends to be wary of new financial models due to the attached risk for investors, and has as a result become incredibly risk averse with regards to new market entrants. The FCA has developed a narrow focus on consumer protection, and perceives all financial models and services as a 'consumer product'. It has come to focus so closely on 'consumer welfare', that it ignores the potential to promote 'total welfare': the promotion of a healthy, flourishing and diverse financial market. This has impacted negatively on the potential diversity of the financial sector, and has limited the opportunity for communities and small businesses to draw on and tap into new avenues for finance.

What is currently working

Drawing from the crowd

With utility bills at their highest and trust in energy companies at its lowest, communities and individuals across the country are turning to alternative means to innovatively disrupt the status quo and take greater control, both of their local energy market and their personal finances. Peer-to-peer lending, co-operative share offers and other forms of crowdfunding have opened up direct paths for individuals to invest in or lend to energy generation projects. With household bills likely to rise further and with interest rates dwindling, many individuals have seen such platforms as an opportunity to generate good returns on their investments and 'offset' the cost of their energy. For those in rented accommodation or without the capital to benefit from their own solar panels, micro-investments of this nature offer a low-cost way into the market and the chance to engage.

Crowdfunding – where projects and businesses are financed through small contributions from a large number of sources rather than through just a few or one – has grown significantly in recent years. Worldwide, crowdfunders contributed $2.7 billion in 2012, which has helped to fund more than one million projects.[5] In the UK, £5.2m has been invested in renewable energy projects through Abundance Generation alone – an intermediary platform which brings together people and businesses to raise capital for their business. Seven projects have attracted an average investment of £1500, with many investing just £5. A rapidly increasing number of projects are also being funded or part funded by local share offers. As of August 2013, there had been over 40 share offers raising £17 million from nearly 10,000 investors.[6] This indicates a significant level of demand from people to commit small sums of money to a range of energy projects.

Joint ventures

Joint ownership projects – where communities have partnered with private developers, local authorities or businesses – have been very successful in the UK. As of July 2013, 53% of community energy's operational capacity came from joint ventures with developers, and this level is growing rapidly.[7] In ResPublica's *Community Renewables Economy* report, we predicted that without the deployment of the joint venture model, the growth of community energy would flatline. With joint ventures, the sector could grow 89 times its current size.

The appetite for such models is clearly growing. The Resilience Centre, which brokers joint ventures, has received increasing interest from community groups, local authorities and landowners to partner on renewable energy projects. Over 40 projects, ranging in size and scale from 500kW to 5MW, with a total capacity of 30MW, are now under review. This could amount to a total capital value close to £40 million over the next few years.

Private businesses in particular tend to have greater capacity, resource and financial capability for communities to draw on. Larger developers are more plugged in to the wider supply chains and market processes, offering crucial existing networks that a community would not otherwise have access to. Businesses can pass on their management expertise, alongside project, financial and technical know-how to the community groups they partner with. Beyond equity investment alone, a joint venture can enable the non-community (business) partner to offer additional advice to communities as to how to scale up their project and use the investment wisely.

Wholesale Lending Offers: Successes from overseas

Successful methods to attract finance and investment can also be found overseas, but tend to be most fruitful where community and local energy is deeply integrated into the country's energy market and supported via a diverse banking sector and SME-lending infrastructure. In Germany, the demand for locally-produced energy is much greater – many local suppliers prioritise the purchase of community- and locally-generated energy, and many communities have set themselves the ambition to be 100% independent in terms of their energy needs. It is also because of this ambition that there is a significant level of supply.

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5 Baeck P. and Collins L. (2013) *Working the Crowd: A short guide to crowdfunding and how it can work for you*, London: Nesta.
6 Capener P. (2014) *Community Renewable Electricity Generation: Potential sector growth to 2020: methodology, detailed assumptions and summary of results*, Department of Energy and Climate Change.
7 Harnmeijer J., Parsons M., and Julian C. (2013) *The Community Renewables Economy: Starting up, scaling up and spinning out*, London: ResPublica.

Around half of the capital borrowed by co-operative energy groups comes from co-operative banks, and another third from development loans originating from Germany's KfW promotional bank. KfW – the German Government's intermediary which underwrites loan finance via commercial banks – offers long-term loans at a rate of 1.0% interest, which has enabled many community energy groups to more easily start up and grow. Germany's local and co-operative banks have also led to the development of good relationships between lenders and local borrowers. Bankers have a much greater understanding of the models and risks involved, and a greater level of trust in the businesses that they lend to.

The Way Ahead

Embedding community energy in the wider energy market

The Government's Community Energy Strategy, launched in January 2014,[8] sets out a significant and encouraging first step to providing an infrastructure of support for the growing community energy sector. But community energy will always be lacking in the UK unless it is properly integrated into the wider energy market. Improving the prospects for investment and lending is a worthy goal, but this will only enhance what already exists rather than initiate the more urgent reform needed. There is an overwhelming consensus that the UK's energy market needs to become more diverse, and political acceptance on both sides of the House that the dominant model must not pervade. Community energy opens up one significant way to begin to achieve this goal. By making community energy central to the way that our communities and energy systems work – and by consequently increasing demand of such generation – we would begin to foster an environment in which projects could become self-sufficient and profitable. Enabling community energy groups to directly supply the power that they generate to their investors and localities, is one key opportunity to incur such a move.

Increasing demand for community energy could act as a market incentive to encourage the setting up and scaling up of community energy. There is an emerging ambition across a number of UK-based suppliers to purchase a certain amount of their power from community energy groups, and incur the introduction of a 'community energy tariff' for their customers. Co-operative Energy, for example, have set themselves the ambitious target of 160MW renewable to source from community groups and independent generators, by the end of 2016. As community energy generation projects need to establish Power Purchase Agreements in order to demonstrate that they have a sound business plan and expected returns to potential investors, such demand is crucial.

True visionary change requires a holistic and integrated approach. Models that are beginning to incur such integration, such as self-supply, where communities can directly use what they produce, should be encouraged.

Making energy more accessible, understandable and tangible

The integration of community energy into the wider energy market is crucial, but equally as important is its integration into wider society. The way that our energy systems work is neither tangible nor very attractive to the general population. Key to bringing community energy projects into the mainstream will be in de-complicating and 'humanising' energy, and making methods of production and energy efficiency more accessible, appealable and easy for consumers to engage with and understand.

Peer-to-peer lending, community share offers and other forms of crowdfunding have started to open up community and renewable energy to a much wider audience: they appeal to those who want to invest a little and benefit from good returns. Such models and methods, and the surrounding framework of tax incentives for investors, should be further supported. The Enterprise Investment Scheme (EIS), which offers tax reliefs to investors who purchase shares in smaller higher-risk trading companies, has benefitted a wide range of community energy groups looking to raise capital. However, with the tightening of the rules in the Spring 2014 Budget, many renewable businesses will now miss out from this scheme. Such narrowing of incentives must be carefully reviewed where a community or 'crowd' of investors are involved in a project. The drop in incentives to investors will hit them harder than larger private businesses.

The recently introduced Social Investment Tax Relief (SITR) will also incentivise wider lending to certain social enterprises. Missing from this incentive, however, are Companies Limited by Guarantee (CLG) and co-operatives beyond the 'Society for the Benefit of the Community' (BenComm) business model, which will mean that successful enterprises, such as the Resilience Centre will miss out.

8 Department for Energy and Climate Change (2014) *Community Energy Strategy: Full report*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275163/20140126Community_Energy_Strategy.pdf.

In order to further tap into the growing interest in micro-investments and lending, such reliefs must be extended to other business models. The European Commission's emerging Energy and Environment State Aid guidelines, and the introduction of competitive allocation of subsidy, should also be interpreted and applied to the UK with careful consideration of community energy groups, to ensure that they are not put at a major disadvantage due to the new measures.

Other popular means of investment – such as tax-free saving – should also add to such incentives. In the Spring 2014 Budget, the Chancellor announced that some peer-to-peer and peer-to-business loans will have a tax-free status, where savers will be allowed to include loans they make on such platforms in their new £15,000 single ISA limit. Debt-based securities, which are offered by many peer-to-peer lenders and via crowdfunding, and which are currently excluded from this scope, should also be given ISA status to open up to a wider group of investors.

For the even harder to reach, renewable technology and energy efficiency measures should simply be integrated into everyday life. New building regulations could be brought in to mandate the inclusion of certain renewable and sustainable technology into all buildings, as well as high energy efficiency standards. Many consumers do not want to have to engage with complicated facts and figures regarding purchase of technology, or carry out cost benefit analyses – they simply want to know that the lights will turn on when they click a switch. To encourage the uptake of different forms of energy, making sure that they are effortless for people to use is a strong first step.

Creating a healthy lending and investment infrastructure

With the withdrawal of the Co-operative Bank from its renewable and community energy investment portfolio, and the barriers faced by investors which prevent them from lending to SMEs and voluntary groups 'at scale', the future shape of the UK's lending and investment infrastructure is crucial. In the immediate future, the 'green' and 'social' investment worlds need to talk to one another and co-ordinate where possible on building a successful lending market. Where gaps are particularly prominent, such as in the pre-development stage, Government could introduce loan guarantees to begin to ease up lending. Beyond Government grants and loans, which are limited in funds and scope, finance from other sources should be encouraged.

Private businesses, local authorities and Local Enterprise Partnerships should also play a much greater role. Larger energy companies, for example, should be encouraged to fund and 'create their own competition' by underwriting the development phase for community energy projects – whether these be community producers or suppliers – and a significantly increased level of revenue generated from shale gas developers (which currently stands at only 1%), or an ownership stake, should be offered to communities.

The Bank of England could also play a role in facilitating greater investment. For renewable energy, the biggest development in the last year has been the creation of a secondary market – where investors purchase securities or assets from other investors, rather than from issuing companies themselves. Extending this down to the community renewables market could help it to diversify and enhance investor confidence.

There is also a serious need for a review of regulation. Rather than giving focus to consumer welfare alone, regulation should be geared toward 'total welfare' – an outcome that aims to see a diverse and liquid financial market, which can offer the range and choice that small businesses and community energy groups need to raise or borrow capital. Regulation should also be proportional to the size of the financial service. Larger, more established, banks and financial services should be subject to greater regulation, whereas smaller platforms that facilitate micro-investments and lending to small businesses should be subject to less regulation to encourage new market entrants to innovate and grow.

In the long-term, the Government must review how it can facilitate a greater and more diverse market for debt finance, which could plug the gaps in start-up and developmental funding for community energy groups and all SMEs. This could be achieved through a new infrastructure bank, similar to the KfW bank in Germany, which offers low interest loans for start-ups and business development. The three existing infrastructure banks in the UK – Big Society Capital, British Business Bank and Green Investment Bank – could be merged to form such a body. This would reduce unnecessary duplication, and avoid confusion as many smaller organisations are currently eligible for funding from all three banks. Simplifying the process could help groups to levy funds from investment banks more easily. A larger centralised store of money would allow for greater private sector investment as it would decrease investment risk in the relevant sectors.

The majority of the reforms needed will not require additional expenditure; we simply need the right institutions and infrastructure in order to make them work.

Participants

This 'Way Ahead' publication is a snapshot of a roundtable discussion held on 13th March 2014, the participants of which were:

1. Maria Allen, Special Adviser to Greg Barker, DECC
2. Phillip Blond, Director, ResPublica
3. Richard Braakenburg, Vice President, Transaction Team, Green Investment Bank
4. Jonathan Bullock, Head of Project Finance, DZ Bank
5. Andrew Clarke, Director, Resilience Centre
6. Andrew Croft, Chief Executive, CAN Invest
7. Steve Cronin, Head of Lending Social Economy, Unity Trust Bank
8. Bruce Davis, Managing Director, Abundance
9. Ramsay Dunning, Group General Manager, Co-operative Energy
10. Alasdair Grainger, Deputy Head of DECC, Commercial Team, DECC
11. Julia Groves, Managing Director, Trillion Fund
12. Caroline Julian, Head of Research, ResPublica
13. Paul Monaghan, Director, Up the Ethics
14. David Powell, Economics Campaigner, Friends of the Earth
15. Robert Rabinowitz, Chief Executive, Pure Leapfrog
16. Laura Sandys MP, Member of Parliament for South Thanet
17. Nick Temple, Director, Business & Enterprise, Social Enterprise UK
18. Adam Wildman, Research Manager, ResPublica
19. James Wright, Policy Officer, Co-operatives UK

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