



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 3

6th March 2019

Direct Investment Portfolio (DIP)
Investment Proposal: Albion Community Power Ltd.

Purpose of Report:

To set out a proposal for a follow up investment of £20m within the Direct Investment Portfolio.

Recommendations:

The Committee is asked to **APPROVE** an investment of £20m in Albion Community Power Ltd. by the Direct Investment Portfolio.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes ☐ No ☐ consulted: Yes ☐ No ☐

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1 Background

1.1 Portfolio Establishment

In December 2009, the Strathclyde Pension Fund Committee agreed to establish a New Opportunities Portfolio (NOP) with a broad remit to invest in assets for which there was an attractive investment case but to which the current structure did not provide access.

1.2 Review

The NOP strategy was reviewed in 2012 and in 2015. It was re-branded as the Direct Investment Portfolio (DIP) in 2015. The most recent review of the DIP strategy and operating arrangements was concluded in December 2018.

1.3 Implementation Framework

DIP investment proposals are assessed on their own merits within an agreed implementation framework based on SPF's overall risk-return objectives and specific DIP parameters.

The framework agreed at the 2018 review is summarised below.

Direct Investment Portfolio	
Objectives	Primary objective identical to overall SPF investment objective. Secondary objective of adding value through investments with a positive local, economic or ESG (environmental, social, governance) impact.
Strategy & Structure	In line with SPF risk-return framework but focused on Equity, Long Term Enhanced Yield and Short Term Enhanced Yield asset categories.
Risk and Return	Portfolio benchmark return of CPI +3% p.a. Individual risk and return objectives for each investment.
Capacity	Target allocation of 5% of total Fund (based on Net Asset Values). Range of 2.5% to 7.5% of total Fund.
Investment Size	Target: £20m to £100m Minimum: £10m Maximum: greater of £200m or 1% of Total Fund Value.
Decision Making	3 stage process with review and satisfactory due diligence by officers, followed by a presentation to the Sounding Board before a proposal is taken to Committee for approval subject to completion of legal documentation.
Monitoring	Includes individual investment reports, participation in advisory boards, and a quarterly DIP monitoring report which is reviewed by the Fund's Investment Advisory Panel

The following proposal has been assessed using this framework and is considered appropriate for recommendation to the committee.

2 New Investment Proposal

2.1 Key Terms

Name	Albion Community Power Ltd.
Investment vehicle	UK Private Limited Co.
Manager	Albion Capital Group LLP
Sector	Renewable Energy
Investment objective	To invest in small scale UK wind, solar, hydro & Biomass renewable energy projects.
Term	To 31/1/35
Target fund size	N/A (open ended)
Proposed DIP investment	£20m
Target return	Internal rate of return (IRR) of 7% (Net)

2.2 Investment Summary

Albion Community Power (“ACP”) is a Renewable Energy firm specialising in acquiring small scale (sub-10MW) assets via off-market transactions which receive government subsidies through the Feed in Tariff (FIT) and Renewables Obligation (RO) schemes.

In 2014, the Direct Investment Portfolio invested £10million in ACP alongside Green Investment Bank (GIB), Greater Manchester Pension Fund, Merseyside Pension Fund, and a number of retail shareholders resulting in a company with £65m total equity. SPF committed a further £10m in 2015 and Merseyside PF a further £10m in 2018 bringing total equity to £85m.

In 2017 GIB sold its shares to Gravis Capital Partners (“Gravis”) Infrastructure Investments Ltd. following the acquisition of GIB by Macquarie. At the same time ACP began the process of allowing its retail shareholders to realise their investment by facilitating their sale via Gravis. This has simplified the ownership structure, resulted in ACP changing its status from a plc to a private limited company, and allowed investors more control as all are now aligned as institutional investors. It should also simplify the exit process when the time comes.

It is proposed that SPF should invest a further £20m in ACP which will continue to target small scale UK based renewable energy projects. Investing at this stage will allow ACP, which is currently fully invested, to take advantage of a visible pipeline of low risk projects that have already received their subsidy accreditation and do not feature any construction risk. Future investments are likely to include additional stakes in existing assets.

More information on the investment manager is detailed in **Schedule 1**.

2.3 Investment Rationale

The Government has a long term commitment to the increased use of renewable energy. This is driven partly by the commitments given to the EU to generate 15% of all power from renewable energy by 2020 and partly by the needs of energy security. A potential shortage in supply towards the end of this decade also dictates an increase in renewable energy investment as part of the solution

The company's aim is to become one of the UK's largest producers of community scale renewable energy, building capacity of around 30MW at a cost of £100m. This would represent approximately 0.1% of the UK target by 2020, equivalent to powering over 35,000 homes.

ACP sees a strong pipeline of potential assets emanating from changes to the market and subsidy regimes. The proposed investment portfolio will comprise fully operational, onshore UK assets in the sub-10MW category, benefitting from 20 year FiT subsidies.

Invested capital and target return will be repaid over the lifetime of the assets through cash distributions.

2.4 Investment Specific Risks

The main risks of the proposed investment in ACP are considered to be as follows:

- Ability to Source Opportunities
- Operational Risk
- Sector Specific Risk
- Regulatory or Legislative Risk

A summary of investment specific risks and key mitigants is contained in **Schedule 2**.

2.5 Projected Return

The target return is estimated at an IRR of 7% based on a long-term hold, potentially to 2035. This is consistent with DIP expectations for post-construction, unleveraged infrastructure assets. Some leverage may be used in order to increase the return to 8%. (Note that at the time of Strathclyde's initial investment the target IRR was 11–13% based on an exit after five years, potentially through flotation. This return has been achieved, but the exit strategy has changed).

2.6 Exit

The manager's strategy is now a long-term hold (16 years). The long-term strategy is a lower risk/lower return structure as ACP is no longer taking significant construction risk. There are provisions in the investment documents for investors to initiate an earlier exit. At this time the intention of the other investors is to hold the investment long term (or to maturity).

2.7 Fees

Fees are in line with DIP's current experience in the infrastructure market. Management fee applies to invested capital only, not committed capital, and includes a step down at the end of the investment period. Carried interest provisions also apply.

2.8 Environmental Social and Governance Issues

Renewable energy is at the forefront of efforts to de-carbonise the global economy. ACP estimates a CO₂ saving of c.750,000 tonnes over the life of the assets in the portfolio, enough to power c.20,000 homes. This would increase to 1m tonnes and around 25,000 homes with an expanded portfolio.

An Environmental, Social & Governance (ESG) investment policy is currently applied to all investments managed by ACP following the Green Investment Bank methodology. ACP has also now applied to become PRI (UN Principles for Responsible Investment) signatories.

In addition, over £300k in community benefits payments will be made over the lifetime of the portfolio.

2.9 Investment Size and Cash Requirements

SPF Fund value at 31st December 2018	£20,763m
DIP allocation (target 5% of main fund) NAV	£1,038m
Current DIP NAV	£711m
Headroom v NAV	£327m

2.10 Investment Strategy

The original DIP investment was classified as part of SPF's Equity allocation. Given the change in ACP's strategy, it would now be considered part of the long term enhanced yield allocation (LTEY). Infrastructure (renewable energy infrastructure in particular) is a key area of investment focus for DIP. Allocations following this investment, based on Fund values at 31st December 2018 and total DIP commitments to infrastructure / renewable energy, would be as follows.

Infrastructure/Renewable Energy, £ in DIP	£716m
Infrastructure/Renewable Energy, % in DIP	66%
Infrastructure/Renewable Energy, % Total Fund	6.8%
LTEY, % Total Fund (target 20%)	16.7%

3 Policy and Resource Implications

Financial: Investment of £20m to be drawn as required. Overall the fees are in line with market.

Legal: The investment will be subject to satisfactory completion of due diligence,

	including review and execution of appropriate legal documentation.
<i>Personnel:</i>	None.
<i>Procurement:</i>	None.
Council Strategic Plan:	Not applicable.
Equality and Socio-Economic Impacts:	
<i>Does the proposal support the Council's Equality Outcomes 2017-22</i>	Equalities issues are addressed in the Fund's responsible investment policy.
<i>What are the potential equality impacts as a result of this report?</i>	No specific impact from this proposal.
<i>Please highlight if the policy/proposal will help address socio economic disadvantage.</i>	
Sustainability Impacts:	
<i>Environmental:</i>	See section 2.8
<i>Social, including Article 19 opportunities:</i>	See section 2.8
<i>Economic:</i>	See section 2.8
Privacy and Data Protection impacts:	To be fully provided for in the legal documentation for the proposed investment.

4 Recommendation

The Committee is asked to **APPROVE** an investment of £20m in Albion Community Power Ltd. by the Direct Investment Portfolio.

Investment Manager: Albion Capital Group LLP (“Albion”)

Albion originally started life as the venture capital arm of Close Brothers in 1996. The company then rebranded to form Albion Ventures in 2009 after a management buyout. Most recently it rebranded as Albion Capital Group LLP (“Albion”). Albion currently manages over £1 billion of assets. Albion provides staff and resources to run Albion Community Power (“ACP”), which is a power generation company developing community-scale renewable energy projects in the UK.

ACP has two executive Directors and three non-executive Directors who have considerable experience in the renewable energy sector. The executive Directors’ services are being made available by Albion, which has a strong expertise in renewable energy projects.

The appointment of Albion to provide these services was for an initial period of five years, but subsequently extended until 31 January 2035, subject to a two years’ notice period from 29 May 2018.

ACP builds, owns, and operates renewable energy plants across the UK in a range of smaller scale projects using proven technologies including hydroelectricity, battery storage, on-shore wind, biogas and anaerobic digestion. Subsidiary Special Purpose Vehicles may be used for individual assets.

ACP is continuing to build on its extensive pipeline of potential projects which includes both acquisitions of operational projects and those in the developing areas of the market, such as energy storage. This pipeline supports ACP’s aim of building a renewable energy business with over £100m of assets.

Investment Specific Risks

Ability to Source Opportunities

The management team behind ACP is well established in its sector of the market place and as such sees a steady pipeline of opportunities. The team currently has sight of £130m of potential transactions. Many of these are with counterparties ACP has dealt with before and are therefore off market transactions.

Operational risk

There is always some risk that assets will not perform as forecast. To mitigate that risk ACP has a diversified technology and geography. The company has a large portfolio of smaller scale assets in various renewable technologies spread around the UK and Northern Ireland. They are experienced asset managers who employ sector specialist companies to manage the day to day operations of all assets. These operators manage day to day maintenance and highlight any technical issues in the first instance to resolve them or minimise operational impact. Wind turbines have a manufacturer's warranty covering long term availability (15-20 years). These performance warranties include cash payments for underperformance. As well as this, ACP has business interruption insurance. This is in place for all assets and covers the loss of profits for a contracted period after an asset has been unavailable for an agreed period.

Sector specific risk

The projects' revenues will be dependent upon wind and rainfall conditions on site. These factors can change materially year to year. If a site has a lower wind/solar/hydro performance than anticipated this would adversely affect the electricity production and ultimately the revenue of the asset. Over the long term, the variances will tend towards a long term average. Part of the due diligence is to ensure that ACP is content with the long term energy expectations and that they are conservative.

Regulatory or Legislative

The risk of falling wholesale electricity prices is mitigated by the fact that investment in energy infrastructure is underpinned by a subsidy regime. A key risk to the investment therefore is the potential removal of existing subsidies by governments. This may come about due to a reduction in support for renewable energy or a significant change in the makeup of a government. In the UK such retrospective changes have never occurred and are considered unlikely to do so in future because of i) the UK Government's requirement to meet its renewable energy targets and ii) its need to maintain commercial and political credibility.