Item 6(a)

25th November 2020

Glasgow City Council

Strathclyde Pension Fund Committee

Report by Richard McIndoe, Director of Strathclyde Pension Fund

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Direct Investment Portfolio (DIP)
Investment Proposal – Quinbrook Renewables Impact Fund

Purpose of Report:

To set out a proposal for an investment of £50m within the Direct Investment Portfolio.

Recommendations:

The Committee is asked to **APPROVE** an investment of £50m in Quinbrook Renewables Impact Fund by the Direct Investment Portfolio.

Ward No(s): Citywide: ✓

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

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 the UK and the 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 review by the Sounding Board with a view to a recommendation being made to the Committee.

2 New Investment Proposal

2.1 Key Terms

Name	Quinbrook Renewables Impact Fund
Investment vehicle	English Limited Partnership
Manager	Quinbrook Infrastructure Partners
Sector	Renewable Energy
Investment objective	to construct a portfolio of renewable energy generating assets, battery storage and grid support infrastructure.
Term	12 years (plus 3x1 year extensions)
Target size	£500m (Hardcap £1bn)
Proposed DIP investment	£50m
Target return	9.9% IRR (Net) / Cash Yield 6%+ p.a.

2.2 Investment Summary

Quinbrook Infrastructure Partners ("QB") is a specialist "value add" investment manager which originates, constructs and manages direct investments in low carbon and renewable energy infrastructure assets.

The QB Renewables Impact Fund ("QRIF" or "the Fund") is a continuation of QB's previous investment strategies, including its most recent fund, the QB Low Carbon Power Fund ("QLCPF"). This fund has successfully raised, and by the end of 2020 expects to have fully deployed, US$1.6bn of investor commitments in the US, UK and Australia. Of this fund, 7 assets have been invested in the UK with up to 6 more anticipated, or being under exclusivity.

The investment strategy for QRIF is to build a portfolio of UK renewable energy generating assets, battery storage and grid support infrastructure which will support the UK in achieving its Net Zero emissions target by 2050.

A commitment by the Direct Investment Portfolio of £50m to the QRIF fund is proposed.

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

2.3 Investment Rationale

For the QRIF fund, QB seeks to invest in established technologies including solar, onshore wind and battery storage infrastructure, either individually or in combination (e.g. solar assets and battery storage configurations), in addition to grid support infrastructure. The latter is becoming increasingly necessary, and is presenting attractive

opportunities for asset managers with the appropriate expertise and track record in this field.

The requirement for grid support infrastructure is a consequence of the UK‘s increasing shift from a mainly coal and gas-fuelled power generation system to the current, more intermittent, renewable energy platform. This creates grid reliability/stability issues and therefore the requirement for the specialist engineering/technology solutions which QRIF seeks to supply.

QRIF will target solar PV and onshore wind projects, typically in conjunction with co-located battery storage infrastructure, in addition to standalone storage projects, together with a proportion of "behind the meter" (energy generating assets located adjacent to, and directly supplying large users of energy without utilising the national grid) and "smart grid" infrastructure.

QRIF will adopt a dual strategy in firstly, developing new assets, and secondly via the opportunistic acquisition of underperforming or undervalued operating assets where the QB team believe they can use their experience/expertise to identify solutions and they have an impressive track record in this respect.

One of QB’s highest profile recent projects was a very large solar development in Nevada (believed to be the largest combined solar/battery project in the US) which was acquired as a late stage/distressed development. The project was extended and fully developed in conjunction with the local state planning authorities and the electricity to be generated over the next 25 years sold under a fixed contract to NV Energy, a subsidiary of Berkshire Hathaway.

Smart grid infrastructure encompasses technology to stabilise the grid in respect of both frequency and voltage, and battery storage solutions to alleviate the high and increasing cost of the electricity constraint challenges currently facing the National Grid (“NG”).

The NG has a regulatory requirement to ensure that distributed electricity is maintained within narrow bands in respect of both frequency & voltage, failing which industrial and domestic consumers can suffer blackouts. Synchronous Condensers (“SC”) are a long established and relatively simple engineering solution which ensures grid stability by generating inertia (resistance to adverse changes in frequency/voltage) in the grid system.

The QRIF fund has already successfully tendered for one SC project in South Wales under the NG's Pathfinder Strategy 1, with up to 7 additional projects being available under Phase 2 of the strategy in the second half of 2020. QB believe they are strongly positioned to secure additional SC projects, given they are established operators in this field and in particular

have identified physical sites in most of the required locations stipulated by the NG, which they believe their competitors are unlikely to have.

Furthermore, when weather conditions are favourable (i.e. wind speeds/solar irradiation are strong), the grid is unable to accept all the power generated by the existing renewable energy sector. During the past decade, NG has required to compensate the renewables industry with over £750m in constraint (or curtailment) payments, while the power generated has also been lost.

The provision of commercial scale battery storage infrastructure under NG capacity contracts allows QB to accept/store energy in such circumstances, reducing both the amount of the constraint payments and lost energy. The power can then be delivered to the grid in periods of higher demand (or unfavourable weather conditions) with either scenario likely to be at higher prices. In this respect the inflation-linked revenues under such capacity contracts with NG are effectively akin to a retainer payment.

QB already has a well-developed pipeline of UK wind, solar, battery and grid opportunities resulting from its QLCPF fund activities and network of early stage renewable energy development partners and the team are relatively confident they will be able to fully deploy the Fund (even at the hard cap level).

2.4 Risks

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

- Development Risk
- Construction Risk
- Generation Risk
- Price Risk

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

2.5 Projected Return

The target (blended) return of the various elements of the Fund's strategy is an IRR of 9.9% (Net). A Cash Yield of 6%+ p.a. is targeted with effect from the operational phase of the projects.

This target return is higher than DIP would typically see for more generalist renewable energy funds. This is due to the assets typically being late stage development, pre-construction and/or (operationally) underperforming, combined with the higher returning, smart grid infrastructure assets. QRIF's assets however will not benefit from the now discontinued, renewable energy subsidy regimes.

2.6 Exit

QRIF has a fixed term of 12 years with an additional three one-year extensions. While QB will not actively seek disposals, the manager's experience has been that unsolicited offers are periodically received for certain assets. These will be actively considered if the terms are compelling and return enhancing.

2.7 Fees

The Management Fee is typical of DIP's renewable energy portfolio and of the current market. The fee will be calculated on total commitments during the 3 year investment period and on the net acquisition costs thereafter, which is in line with market practice.

SPF will benefit from a number of negotiated discounts in the management fee by virtue of:-

i) the amount of DIP's proposed commitment;
ii) for investing at first close; and
iii) a LGPS aggregation discount.

Carried interest provisions also apply. These are structured such that QB require to perform strongly before they benefit under these provisions.

It is not anticipated that Quinbrook will experience any material difficulty in raising the full targeted fund size of £500m and the fee structure is considered satisfactory.

2.8 Environmental Social and Governance Issues

QB's core business is dedicated to building sustainable energy infrastructure and real asset based solutions having a long-term positive impact on the climate, environment, local economies and communities.

The firm integrates awareness and management of ESG issues throughout the investment cycle, in due diligence, as part of Investment Committee decisions, portfolio company operations, ongoing ownership and exit of invested assets and in its engagement with the wider community.

QB became a signatory to the PRI (UN Principles of Responsible Investment) in April 2016 and has been awarded the highest rating (A+) for each mandatory reporting year since then. Founder David Scaysbrook was a member of the inaugural UNPRI Infrastructure Advisory Committee and is Chair of the Centre for Climate Finance & Investment Advisory Board in London. QB is also sponsor of the Imperial College Centre for Climate Finance & Investment and a supporter of the Task Force for Climate Related Disclosures (TCFD).

QB's Advisory Board Chairman, Mark Fulton, is a Senior Advisor to the Carbon Tracker Initiative, a Senior Fellow at CERES and a Special

Advisor to the Climate Bond Initiative, 2* Investing Initiative and the PRI, among other positions held.

The QRIF fund will help to facilitate progress towards a carbon net-zero UK economy. c.334,000 tons of CO^2 emissions could be displaced each year the projects are operational. c.130,000 tons of this relates to Scottish projects.

2.9 Investment Size and Cash Requirements

SPF Fund value at 30th September 2020	£23.701bn
DIP allocation (target 5% of main fund) NAV	£ 1,185m
Current DIP NAV	£ 866m
Headroom v NAV	**£ 319m**

2.10 Investment Strategy

The proposed investment falls within the Infrastructure/Renewable Energy sector and therefore the Fund's Long Term Enhanced Yield allocation. Infrastructure (renewable energy infrastructure in particular) is a key area of investment focus for DIP.

Allocations following this investment based on SPF values at 30th September 2020 and total DIP commitments to infrastructure/renewable energy would be as follows:

Infrastructure/Renewable Energy, £ in DIP	£ 813m
Infrastructure/Renewable Energy, % in DIP	62.2%
Infrastructure/Renewable Energy, % of Total Fund	3.4%
LTEY, % Total Fund (target 52.5%)	15.9%

3 Policy and Resource Implications

Financial:	Investment of £50m to be drawn as required. Fee structure is in line with market.
Legal:	The investment will be subject to satisfactory completion of due diligence, including review and execution of appropriate legal documentation.
Personnel:	None.
Procurement:	None.
Council Strategic Plan:	Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio-Economic Impacts:	
Does the proposal support the Council's Equality Outcomes 2017-22	Equalities issues are addressed in the Fund's responsible investment policy.
What are the potential equality impacts as a result of this report?	No specific impact from this proposal.
Please highlight if the policy/proposal will help address socio economic disadvantage.	No specific impact from this proposal.
Sustainability Impacts:	
Environmental:	See section 2.8
Social, including opportunities under Article 20 of the European Public Procurement Directive:	See section 2.8
Economic:	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 £50m in Quinbrook Renewables Impact Fund by the Direct Investment Portfolio.

Schedule 1

Investment Manager: Quinbrook Infrastructure Partners

Quinbrook Infrastructure Partners ("QB") are renewable energy specialists who are highly experienced in managing late stage, development/construction projects and underperforming, operational power generating assets.

The firm was established in 2015 by Managing Partners Rory Quinlan and David Scaysbrook ("the Founders") who have worked together for 30 years in the renewable energy investment sector, including 5 years with Capital Dynamics (at Senior MD level) immediately prior to forming QB.

The Founders have raised US$2.6bn across six prior funds from 40 institutions (including 10 UK LGPS funds) for low carbon and renewable energy infrastructure projects since 2010. QRIF will be their seventh investment fund focused on low carbon power generation, storage and "smart grid" infrastructure assets.

Together with senior partners Hank Jones and Karl Olsani, the Founders have collectively deployed c. US$8bn of equity into energy assets (equating to 19.5 GW of capacity) mainly in the US, UK and Australia both with QB and while at previous fund managers. This includes 120+ UK based power and renewables projects since 2000 across onshore wind, landfill gas recovery, hydro and grid support assets.

Investment Specific Risks

Development Risk

This is the risk that the contracts, planning and permit/licensing approvals required for a project to proceed are not obtained or are subject to conditions which make the project unviable. This could include planning, grid connection or lease conditions. QB focuses on wind, solar and battery storage technologies which typically have lower development risk than more complex renewable technologies.

QB seeks to mitigate development risk by investing in diverse platforms with multiple projects in different assets, stages of development, locations, licensing authorities and power off-takers (energy companies or commercial consumers who buy the power). In this way, the failure of any single development project will not adversely affect the overall portfolio of projects. Development risk is further mitigated through extensive due diligence undertaken throughout the investment, development and construction process. This is the essence of the QB team's expertise and their track record of success to date has been founded on investments in development stage opportunities.

Construction Risk

This is the risk of cost over-runs in the capital budget of a fully developed project and/or the cost of delays in completion. QB is expected to invest only where such construction costs can be fixed or capped and where they have experience and confidence in the construction methods, the contingency allowances and in the contracting parties themselves. The cost overrun risk is normally also mitigated through the use of retentions, guarantees and other forms of support in order to pass the majority of the risk to the construction contractor. QB has a strong track record of managing construction projects on time/within budget.

Generation Risk

The estimation of expected energy production is a key aspect of the due diligence process for the QB team and is where they see what they consider to be overly optimistic assumptions. Their operating experience allows them to mitigate this risk.

Price Risk

Gas-fuelled power normally has a relatively heavy influence on electricity prices and the impact of lower gas prices and lower demand due to Covid-19 during 2020 has adversely affected the market. QB believes these issues will have a relatively low impact on the fund's overall returns because of several factors including:

- the timing of the expected recovery relative to when the fund's investments will reach completion (QB takes a more prudent view of the anticipated recovery period than most market commentators);
- the medium-term strengthening of gas prices and power demand;
- the high level of fund revenues which are expected to be insulated from wholesale price volatility. These include inflation linked grid stability contracts with NG, PPAs (Power Purchase Agreements) and/or "behind the meter" contracts with investment grade counterparties; and
- assets (mainly battery storage) which are structured to take advantage of peak demand (or low renewable energy supply) periods when prices are higher.