



Glasgow City Council
Strathclyde Pension Fund Committee

Item 6

24th November 2021

Report by Richard McIndoe, Director of Strathclyde Pension Fund

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**Direct Investment Portfolio (DIP)
Investment Proposal – Temporis Impact Strategy V LP**

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 Temporis Impact Strategy V LP 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 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 recommendation by the Sounding Board to the Committee.

2 New Investment Proposal

2.1 Key Terms

Name	Temporis Impact Strategy V LP
Investment vehicle	English Limited Partnership
Manager	Temporis Investment Management Ltd
Sector	Renewable Energy
Investment objective	To invest in a diversified portfolio of development, construction and operational renewable energy projects and technologies, mainly in the UK
Term	10 years (plus up to 2x1 year extensions)
Target size	£350m (Hard Cap £500m)
Proposed DIP investment	£50m
Target return	10-12% IRR (Net)

2.2 Investment Summary

Temporis Impact Strategy V LP (TISV) is being established by Temporis to make a meaningful contribution to the delivery of the UK's net zero target by:

- delivering a diversified portfolio of high-impact renewable energy (RE) generating and storage assets; and
- investing in enabling technologies that will assist and promote the UK's transition to a low carbon economy.

TISV is Temporis' 5th fund although the first to be named an "impact fund". It aims to generate attractive returns through the development and construction of a 1.5GW - 2GW portfolio of RE assets located mainly in the UK, and/or by acquiring operational assets where an opportunity is identified to add value.

DIP has previously invested £30m in each of Temporis' 2 previous funds, namely Temporis Renewable Energy Fund (TREF) and Temporis Operational Renewable Energy Strategy (TORES). Both funds are performing strongly.

A commitment by the Direct Investment Portfolio of £50m to the Temporis Impact Strategy V fund is proposed.

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

2.3 Investment Rationale

2.3.1 UK Renewable Energy Requirements

In 2019 the UK Government amended the Climate Change Act 2008 to commit the UK to achieving net zero emissions by 2050.

The electricity system will be the key to delivering this, both through the ongoing de-carbonisation of the current energy generation mix as well as the anticipated doubling of electricity demand by 2050.

This is partly a result of the fast-increasing market share of electric vehicles as well as the increasing electrification of other sectors such as general transport, industry, property and housing, in addition to the increased demands resulting

from population and economic growth. RE will require to supply 80% (currently c.42%) of the *increased* level of demand in order to meet the net zero target. To keep on track for 2050, the UK's existing onshore wind and solar capacity must therefore double in size by 2030, with offshore wind itself requiring to increase in capacity to 40GW. To put this in context, the UK's current RE generating capacity is c.43GW.

The rate of development and construction of new RE generating projects suffered a material decline in the aftermath of the ending of the Renewable Obligations subsidy scheme in 2017 for onshore wind and solar assets.

New RE projects however are now economically viable without subsidies due to several factors:

- the expansion of the Contracts for Difference (CfD) pricing support and stabilisation scheme and its availability to onshore wind and solar projects once again;
- falling technology costs for solar, wind and battery projects;
- wind and solar now having the lowest unit cost of energy;
- carbon prices rising & fossil fuel generation becoming less competitive;
- increased preference of users for energy from renewable sources; and
- the growing public support for RE.

Temporis estimate that by 2030 there is a requirement for investment of £74bn in the RE sector to deliver the additional capacity required to stay on track. Of this it is estimated that £4bn of development equity is required to sponsor projects through their early stages, with the balance required to physically construct the additional capacity.

2.3.2 Fund Strategy

The TISV fund's strategy is to target capital growth (as opposed to cash yield by holding the assets long term) in the following ways:

- Investing in development stage projects and sponsoring these through their development phase (securing land, grid connections and planning);
- Investing in, acquiring, and creating development partnerships and platforms that can bring through a continual pipeline of projects;
- Providing construction capital, often to captive development projects to deliver the projects through to the operational phase;
- Acquiring operational projects where there is the opportunity to optimize and/or add value to the asset; and
- Investing in projects and businesses that are facilitating and enabling the low carbon transition, whether by technology, infrastructure, or services.

Finally the Manager believes that enabling technologies will play a critical role in the UK renewables market, specifically in addressing the challenges of the higher level of intermittency resulting from the increasing scale of the RE sector including grid stabilisation, the development of demand flexibility, new and existing storage technologies and the optimization of the efficacy of new clean energy generation and the further decarbonisation of the sector.

2.4 Risks

The main risks of the proposed investment are considered to be:

- Origination Risk
- Development Risk
- Construction Risk
- Price Risk

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

2.5 Projected Return

TISV's targeted return is 10%-12% IRR (Net). This is considered appropriate for a fund proposing to develop and construct RE assets (and/or acquiring underperforming operational assets) with the attendant risks involved.

2.6 Exit

TISV will have a term of 10 years with an investment period (IP) of 5 years. Repayment is expected to originate from the sale of assets when short operating track records are available, or alternatively if/when it is deemed advantageous to consider opportunistic approaches.

2.7 Fees

The Management Fee is typical of DIP's RE portfolio and of the current market. The fee will be calculated on total commitments during the IP and on the invested capital thereafter, which is in line with market practice.

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

- a LGPS discount;
- a first close discount; and
- a discount based on the amount (£50m+) of the proposed investment.

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

The fee structure for the TISV fund is in line with DIP's experience for a fund of this nature in the RE sector.

2.8 ESG and Climate Change Impact

Temporis is committed to ensuring that each investment contributes directly to resource sustainability and the climate change agenda, whilst aiming to generate strong financial returns for investors. Its corporate culture has sustainability at the core of all its business operations and values.

Temporis consider that a structured approach to identifying and managing ESG issues across the portfolio can significantly enhance the performance of the assets. ESG factors/risks are therefore integrated across the investment and asset management process, from pre-screening to ownership through to exit. The Manager is also conscious of supporting the direct environment of each project, ensuring the ecosystem is not negatively affected and providing the local community with annual monetary benefits.

Temporis has been a signatory to the UNPRI (UN Principles of Responsible Investment) since July 2018.

2.9 Investment Size and Cash Requirements

SPF Fund value at 30th September 2021	£27,907m
DIP allocation (target 5% of main fund) NAV	£ 1,395m
Current DIP NAV	£ 1,053m
Headroom v NAV	£ 342m

2.10 Investment Strategy

The proposed investment falls within the Infrastructure / Renewable Energy sector and therefore the Fund's long term enhanced yield allocation (LTEY).

Allocations following this investment, based on Fund values at 30th September 2021 and total DIP commitments to LTEY, would be as follows:

Infrastructure / Renewable Energy, £ in DIP	£1,011m
Infrastructure / Renewable Energy, % in DIP	72%
Infrastructure / Renewable Energy, % of Total Fund	6.1%
LTEY, % Total Fund (target 20%)	14.4%

3 Policy and Resource Implications

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 2021-25? Please specify. 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.

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify: Temporis has been a signatory to the UNPRI (UN Principles of Responsible Investment) since 2018. This is consistent with Strathclyde Pension Fund's Climate Change strategy, which is being developed in line with Item 34 of the Council's Climate Action Plan.

What are the potential climate impacts as a result of this proposal? A meaningful contribution to the additional renewable energy generating capacity required for UK to stay on track to become net zero by 2050.

Will the proposal contribute to Glasgow's net zero carbon target? Yes, through the development and construction of 1.5GW to 2GW of additional renewable energy generating capacity across the UK, including in Scotland.

Privacy and Data Protection Impacts: To be fully provided for in the legal documentation for the proposed investment.

4 Recommendations

The Committee is asked to **APPROVE** an investment of £50m in Temporis Impact Strategy V LP by the Direct Investment Portfolio.

Investment Manager: Temporis Capital Ltd

Temporis Capital Ltd was established as Cinnamon Capital Management in 2005 and has been authorised/regulated by the Financial Conduct Authority since 2006. It changed its name to Temporis in 2010 and is 100% owned by management. It currently has £465m of assets under management (AUM) and has raised a total of £730m in the RE sector for investment since inception.

Temporis has proven expertise in sourcing, investing, developing, acquiring, constructing, operating, managing and also disposing of assets. To date it has developed, built and/or operated renewable projects with a combined capacity of 434MW across 79 projects and is currently in the process of developing 6.2GW across 78 further projects.

Temporis's development activities provide it with valuable insight to the challenges that developers face, as well as the opportunities for value creation in the development stage. Equally, its experience in the full project lifecycle gives it a deep understanding of the requirements of senior debt lenders and long-term asset owners. This knowledge is recycled into development projects to ensure projects are designed from the outset to meet the requirements of, and be attractive to, lenders and long-term owners.

Temporis has an active strategy and long experience of selling green energy. During the operational phase of assets, it actively manages its merchant exposure, employing seasonal fixes and/or longer term PPAs (Power Purchase Agreements) or CFD's (Contracts for Difference) where considered beneficial.

The Manager has deep experience in the major RE technologies, namely onshore/offshore wind, hydropower, solar and biomass. In the wind sector it is currently developing 2.2GW of onshore projects, has successfully developed 58 projects (43 single turbine assets and 15 windfarms), constructed 63 assets and is operating 20 projects totalling 223MW. Offshore, it is currently developing 4GW across 5 projects in the Irish Sea, while in solar it has acquired, developed and/or constructed 122MW of assets across 11 sites in the UK. It has also successfully developed, constructed and/or is currently operating, 16 hydro-electric assets and a 40MW waste-wood biomass plant in the north of England, in addition to a portfolio of smaller scale biomass plants using agricultural waste feedstock.

Other investors in Temporis include pension funds, sovereign wealth funds, large financial institutions and family offices.

Investment Specific Risks

Origination Risk

Temporis is an experienced fund manager with a strong existing pipeline for the TISV fund for immediate or early investment. The investment team has a proven track record in sourcing deals both directly and indirectly through its affiliates across wind, solar, hydro and biomass technologies. The origination risk is therefore considered to be relatively low.

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 issues.

Temporis seeks to mitigate development risk by investing in diverse platforms with multiple projects in different assets, stages of development, locations, planning 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. The fund will be restricted to a maximum of 25% of commitments in pre-planning stage development assets and the Manager's track record of success to date provides comfort in respect of its experience and expertise in this field.

Construction Risk

This is the risk of cost over-runs in the construction phase of development projects and/or the cost of delays in completion. Temporis is expected to invest only where construction costs are fixed/capped and where they have experience in the construction methods, the contingency allowances and in the contracting parties themselves. The cost overrun risk is normally also mitigated via the use of financial retentions, guarantees and other forms of support in order to pass the majority of the risk to the construction contractor. Temporis has a strong track record of successfully managing construction projects.

Price Risk

Gas-fuelled power normally has a relatively strong influence on electricity prices and the impact of lower gas prices and lower demand adversely affected the market during 2020. In early 2020 however Temporis entered into fixed price or hedged off-take agreements and have benefitted from these during the past 18/20 months. Their intention is to continue to maintain a prudent view of hedging their market price exposure.