
the next lighthouse


LivingPlaces

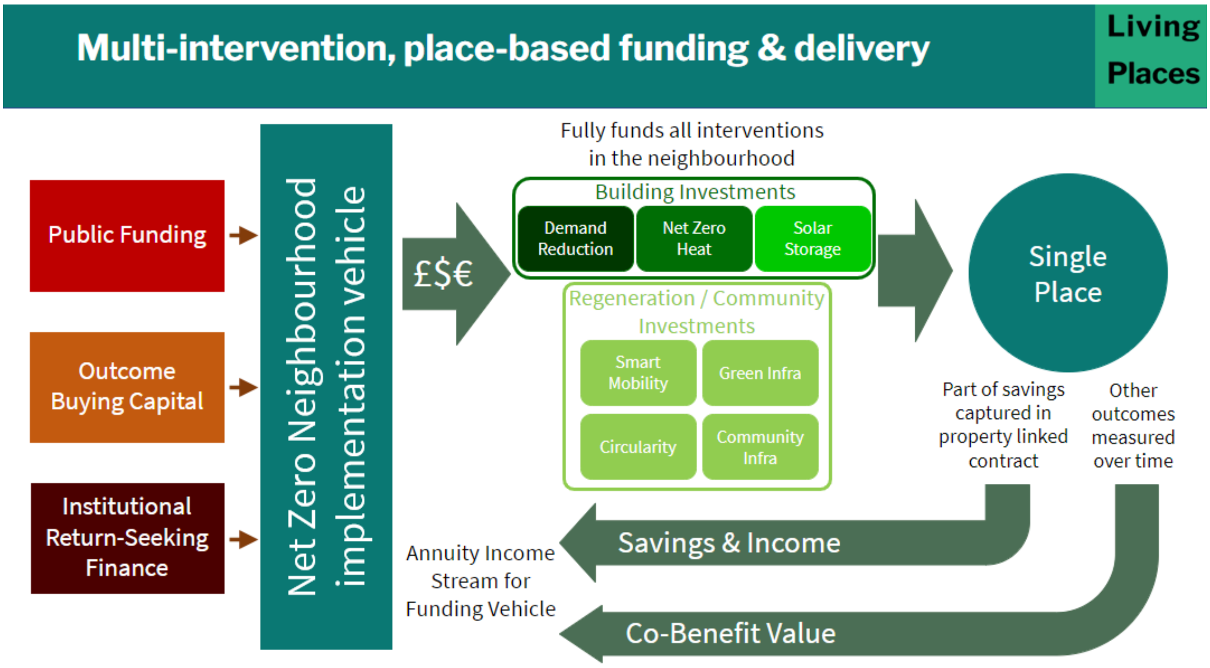
The Next Lighthouse / Living Places – Roundtable 23rd April 2024

The Next Lighthouse and Living Places co-hosted a roundtable that brought together Funders looking to deploy capital in the transition to net zero; Local Authorities that have clear ambitions to decarbonise; and Government Departments and Agencies that are working to foster the right conditions for decarbonisation at pace and scale.

Building on the existing thinking to date, the roundtable supported the process of *activating demonstrators* and using the learnings to develop live discussions with funders/others to *unlock revenue and capital funding*.

It focussed on a place-based model of decarbonisation - or Net Zero Neighbourhoods (NZN). This model enables higher levels of energy efficiency through deeper retrofit, heat decarbonisation and micro-generation. It provides a range of co-benefits to the local community; and a just energy transition by removing the requirement for householders to fund development.

The model aggregates large numbers of multi-tenure properties into a coordinated programme. This creates both economies in the delivery process and a requirement for capital at scale through a blended finance structure combining long term public and private funders as well as outcome buyers.



In order to get the broadest range of perspectives (and challenges), participants at the roundtable included local authorities, government departments and agencies, banks, pension funds and other asset managers.

This note summarises key themes from the discussions which were under the Chatham House Rule.

Key considerations to unlocking capital

Participants were asked to select their top three considerations in relation to unlocking capital. These are captured in the following word cloud and include development risk, long-term policy and credit rating.

Main areas of discussion were as follows:

1. Development risk and funding

   The individual components of a neighbourhood decarbonisation programme do not involve the same level of development risk as larger infrastructure projects; nevertheless, funders such as pension and insurance companies are less likely to be able to take sub-investment grade risk. This means that either projects are funded with separate development finance and then refinanced with long term annuity-type funding or there is an investment grade guarantee which reduces/falls away once projects are through the pre-revenue phase.

   In the planning and construction phases of projects there is a significant need for grant funding to cover technical assistance costs which are unlikely to be capable of being capitalised given the overall return profile of net zero neighbourhoods. In other areas of the transition to net zero, public sector and philanthropic funders have been instrumental in providing this type of funding. A discussion was had on the potential for the private sector to contribute in this case given the scale of the investment market that could be created.

2. Alignment of funder, local authority and community interests

   Whilst funders will seek to optimise risk/return, there will be a need to aggregate a variety of measures and areas; these have differing return profiles in order to ensure that lower returning but important measures such as the electrification of heat and all types of neighbourhoods can secure funding. This will require a heterogenous set of projects to be funded by a relatively uniform capital structure to facilitate raising funds at scale; this is critical as institutional funders will look at both return and ease of deployment.

   A number of participants commented on the need for a clear narrative on the goals of these projects. This narrative would allow investors to categorise them as the multiple cross-sectoral outcomes but cautioned not to complicate benchmarking and portfolio allocation. For generalist funds the involvement of real asset managers in this evolving sector is desirable.

   The governance of the funding/delivery vehicle(s) will need to ensure the effective development and operation of decarbonisation and regeneration assets. Appropriate funder protections include not only intercreditor arrangements; but also protection of the interests of the local community whose engagement is key to higher levels of participation. Key protections should include limitations on excessive profit extraction in the longer term from what are in effect local monopoly assets.

3. Credit rating

   Until there is a better understanding of the risks around revenue generation (principally levels of participation) and collection (energy/comfort payments by householders) funders seeking lower risk investments may look for some credit enhancement through a larger layer of first loss capital/guarantee or parametric risk cover.

   As performance characteristics of net zero neighbourhoods become better understood there is the potential for credit support to fall away or tradeable elements of funding structure to reprice to reflect reducing risk.

4. Policy

   Clear policy signals were considered critical to encourage more and larger demonstrators, activate supply chains and give confidence to investors being asked to take multi-decade risk positions. Part of that signalling could be through tax incentives which have been instrumental in opening up the renewables financing market among others.

Conclusion

Work is already under way in many local authorities, to develop place-based models of decarbonisation. The work points to increasing capital deployment opportunities rapidly in the short to medium term, though a constraint on project development funding is slowing this opportunity.

As these projects move off the drawing board to trials at increasing scale, there is a need to anticipate the requirements of the capital markets and design funding structures accordingly.

Following on from the roundtable we are keen to engage with funders by moving from concept to project archetypes where we can develop outline term sheets for different phases of the funding and different layers of the capital structure which will in turn inform the set-up of new projects.