Underwriting – What is it, why bother & do we need it?

In its simplest form underwriting is a loan to your project, ahead of the project raising the finance required, on the promise that if the finance is not raised, the underwriter will commit their monies to the project on the pre-agreed terms. Sometimes this can be for the full amount of monies to be raised, or sometimes in part.

One of the weaker aspects of community energy projects is the time it takes to raise the community finance – this is called 'time risk.' 'Time risk' because fundamentals could change in this period, and alter the direction of the project.

Ahead of this window of raising the monies, which typically might last from one month to six months, there has already been long hours of hard work put in to the project. All of this hard work is at risk of being undone if the money is not raised, as the project will not be able to proceed. In additional to this, there is time risk associated with the stakeholders in the project, or the main contractor. The stakeholder might be in full agreement with the project at the outset, but if there is a failure to raise the monies in the time provided, they might choose an alternative path.

Having a committed underwriter to a project also buys you time. Community energy has shown over the past 12 months that policy changes can happen over night. Very short timeframes to qualify for a tariff, and periods of uncertainty whilst policy changes are being finalised, can stop a project in its tracks. If the underwriter is already on board with the ethos and general outcomes of the project, and still likely to see a positive outcome for the project, whether reduced in size, or with slightly different legal agreements, then the period of uncertainty will pass without effecting the project.

At the time of the share or bond raise having a committed underwriter to the project should be seen as a sign of strength for potential investors. It means that the project managers have already taken an investor, often of a professional nature, through the economic model, the social impact benefits and worst-case scenarios for the particular project. It also means that if the stakeholder is a local authority who has brought into the community energy model, over a commercial model (who normally has finance upfront) they know that the project is going to go ahead, whether the initial finance raise achieves its' target or not. This is of particular importance if solar PV is being put on residential roofs. There is no point of engaging with tenants, and promising them a reduction in their electricity bills, if after six or nine months the installation never arrives.

So what is the downside?

Funnily enough choosing the right underwriter for your project is key. If it is the wrong underwriter then you might spend a colossal amount of time getting them to understand your project, model, finances and wider aims, and then be hit with high fees for the service, whether it is through arrangement fees, or interest rates on the loans. There is nothing more frustrating for project managers to educate and up skill an underwriter on every aspect of your project, for them to then set an unrealistic lending fee.

Some investors might choose to invest in another project, because it is not underwritten, and therefore might not go ahead, if it does not reach the target. Whilst every project should be judged on its merits, this approach should not be taken. The project with the underwriting starts off on a stronger footing, as the fundamentals have already been examined, and passed.

Energise Barnsley secured the largest amount of underwriting to date for a community energy project - £2 million. The facility was made possible by IGNITE – an impact investment fund with a focus on energy. The facility was not initially granted for Barnsley, and it was not intended to be refinanced by a bond offer.

Through thorough understanding of the project, and core mission of the applicant, Ignite were flexible enough in their approach to be able to keep the same technology and social impacts, whilst changing the regional entity and the nature of the community raise from shares to bonds.

In addition to this, by having the committed underwriting the contractor to the project was able to take 'at risk' work in the knowledge that finance was in place. This included conducting EPC certificates on school buildings in order to preregister them with OFGEM for a community tariff in the two-week period left open by swift policy changes. The solar PV equipment could also be pre-ordered to arrive in time for Q4 2016 installs. None of this could have happened without the underwriting, and half of the Energise Barnsley project would not have gone ahead – the 321 residential installs.

We (Energise Barnsley) would recommend the additional hours it takes to underwrite a community energy project. With the right underwriter on board it reduces time, policy and reputational risk for the project. And it some cases, it provides you the lifejacket you require, if radical policy changes attempt to kibosh your project stone dead. Finally, it removes the stress associated with community raises – the three months or so of will we, won't we get the monies.

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