LAUNCH

Sustainable energy assets as tradable securities

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Deliverable D6.4

Report on activities of Investor Board Final Version

Version 1.0

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1. Introduction

The LAUNCH H2020 project aims to develop and market-test industry benchmark tools and materials for the energy efficiency sector. Both in project finance and private equity specific shortcomings and gaps were identified and are being addressed by a number of tasks and deliverables within the LAUNCH project. To increase the validity of the developed materials and broaden their reach and credibility, the LAUNCH consortium interacts on an ongoing basis with 2 key stakeholder groups: the project developers and the financial institutions. Whereas project developers are directly engaged in the piloting and education activities in WP5, the financial institutions are engaged in (mostly) separate activities through WP6.

The LAUNCH consortium is well aware of the invaluable expertise the financial institutions can bring to the development of tools and processes that should benefit the whole energy efficiency sector. All too often financial players are left out from the discussions and developments of materials that they themselves are supposed to accept and work with eventually. At the same time, we recognize the intrinsic motivation many of these financial institutions bring to the discussion table, as they see the benefit of steering such developments in an even more valuable and useful direction.

This Deliverable represent the second and final version (after the previously submitted D6.3) and describes the range of activities of the Investor Board from May 2019 to October 2021. It presents a collection of the valuable feedback gathered during this period, almost all of which was eventually incorporated into the final versions of different tools (the LAUNCH standardized agreement, the Risk Assessment Protocol, the standardized financial spreadsheet and the company presentation template). Further details on these various standardized tools can be found in the respective Deliverables D2.3, D3.3, D4.2 and D4.4 – all available on the LAUNCH project website[1].

[1] www.launch2020.eu

2. Activities of the Investor Board

2.1 First Investor Board meeting (November 2019)

The first Investor Board meeting took place on November 28, 2019, the day after the LAUNCH Investor Forum in Brussels. Of 15 investors, 12 were able to attend the 3-hour meeting where the main focus was put on the LAUNCH project finance tools: the standardized contract and the Risk Assessment Protocol. Short presentations of the materials were followed by dedicated Q&A sessions on the materials and a wider discussion on investor sentiment and challenges and opportunities in the industry.

2.2 Second Investor Board meeting (April 2020)

The second Investor Board meeting took place on April 1st, 2020, as a 2-hour conference call due to COVID restrictions. 18 investors were present in the call that included presentation on the first LAUNCH pilot round, the LAUNCH standardized agreement and the LAUNCH Risk Assessment Protocol. Further topics of discussion were the impact of the COVID-19 pandemic on the energy efficiency industry, the potential for a European energy efficiency finance association and the creation of the ESG working group.

2.3 ESG working group meeting (April 2020)

The first ESG working group meeting was held on April 23, 2020 with 10 investors present in the 1,5-hour conference call. Key concepts were presented by consortium members, and discussions included the suitable methodology to be applied, the reduction of complexity needed for ease of use and the different ways Investors already gather and treat ESG-related information.

2.4 Third Investor Board meeting (November 2020)

The third Investor Board meeting was held on November 3, 2020 and had 16 investors participating in a 2-hour conference call. Key learnings and developments on the LAUNCH standardized contract, the Risk Assessment Protocol and the sales material were shared, including a first set of case studies from pilot projects.

2.5 Fourth Investor Board meeting (June 2021)

The fourth Investor Board meeting took place on June 9, 2021 with 15 IB members present in the 2-hour conference call. Brief updates on pilot progress and prospective impact were shared, and 2 input presentations from IB members on ESG and carbon trading led to interactive discussions with the whole audience.

2.6 ESG working group feedback (July 2021)

Following the fourth Investor Board meeting, IB members were encouraged to fill in an ESG questionnaire detailing around 50 ESG-related factors that they were asked to grade for their relevance. A handful of responses were collected and informed the further refinement of the ESG-related section in the Risk Assessment Protocol (see D3.3 for further details).

3. Feedback collected on LAUNCH Standardized materials

The activities described in the previous chapter allowed the LAUNCH consortium to collect valuable feedback on the early versions of the standardized materials developed within the LAUNCH project. The following sections summarize the feedback collected from investor stakeholders. Further details on the individual tools can be found in the respective Deliverables D2.3, D3.3, D4.2 and D4.4 – all publicly available on the LAUNCH H2020 website. While the six main activities described above were the main source of feedback in the development and refinement of the materials, as they provided a steady flow of questions and comments, the involvement of IB members in RP2 shifted rather to a number of bilateral interactions with individual consortium partners, providing further insights into possible applications of the materials, further extensions (such as a loan application guideline and KYC tool to be pursued in PROPEL H2020), and their digital integration, which will be an essential precursor to any meaningful wide-spread exploitation in the future.

3.1 LAUNCH Standardized Agreement

First Investor Board meeting (Nov 2019)

General feedback

- Very good inputs received from the investors, they took time to go through the contract properly
- Several investors confirmed that the standardized (static) nature of the contract works for small projects under 500k € with some of the Investor Board members expressed their willingness to use it. For bigger projects, contracts are usually is made in a non-standardized way as the measures implemented and projects are more complex.

Specific feedback on clauses:

- Output needs to be clarified based on a technological backup: i.e. lumen is not enough, we need to include or link the lumen with kWh or CO2 emissions. (the only metric currently included in Schedule 1 of the contract).
- Arbitration mechanics can be a good addition with an independent arbiter who should be appointed upfront. An arbitration provision was included in the current version of the contract.
- Confirmation that “step in rights” (the lenders’ or investors’ ability to replace an ESCO for a series of reasons) are a must.
- Further clarification on the Termination Provision; A soft termination agreement for small projects. The proposed approach from the LAUNCH partners was improved by the Investor Board suggestion with the following:
    - To insert a clause in the contract that the subscriber (client) is responsible to cover the removal cost (at a cost to be agreed), if he wants to break the contract without having a pertinent reason (outside of the reasons already covered in the contract). This is a very important risk on the investors’ side.
    - At the end of the term the subscriber will have the right/obligation to either:
        - Give back the assets i.e. “heating equipment, cooling equipment, lighting equipment, etc.”
        - Or will have the right to purchase the assets at a value to be determined by an independent valuation agent appointed by the subscriber

    - Or will have the right to extend the term based on a new contract with a new refurbished equipment
- The suggested termination agreement will also tackle the off-balance sheet aspect
- To include an Insurance provision (the service provider will insure i.e. the equipment provided)
- Include the presence of a technical supplier or M&V auditor or third-party adviser in the contract – in response to this suggestion currently the LAUNCH partners included in the contract an independent measuring mechanism (a meter and a back-up meter) and an audit clause.

This first round of feedback above was included in the contract by early March 2020.

<u>Second Investor Board meeting (April 2020)</u>

- Occupancy risk needs to be taken in account (we have mitigated this risk with the inclusion of a minimum consumption level)
- The Force Majeure section now includes pandemics
- LAUNCH proposition of proposing upfront 3 company that will step in if the step-in rights would be triggered was rejected by the Investor Board: It did not agree with the proposal as they work with different companies in different countries and the wider the provision is, and less restrictive it is and the more suitable it is from their perspective.
- Countries for transposition proposed by the Investor Board are: Italy, Spain, Portugal, Poland, Germany & France.

<u>Further Investor input collected in RP2 (November 2020 – October 2021)</u>

As explained above, the IB involvement in RP2 shifted from a pure advisory role to a more engaged collaboration with a handful of investment funds and banks who were particularly keen in understanding the potential value of and adopting LAUNCH materials into their processes. With regards to the standardized contract, specifically the off-balance sheet nature of the agreement stirred a lot of interest, with a couple of fund managers openly declaring their intention to create future funds following the LAUNCH securitization model with the off-balance sheet treatment and the right so sell receivables as cornerstones of the funding structure.

While within RP1, the translation and transposition to Luxembourg law was no longer prioritized, conversations with the Advisory Hub at the European Investment Bank led the consortium to reconsider and include Luxembourg in the range of countries for which further legal reviews were undertaken.

One investment fund paired up with a technology provider (of PV panels) and approached the LAUNCH team with a request to use the standardized agreement for their network of PV installers, essentially applying the PVaaS model with no upfront costs and the built-in ability to securitize receivables generated from it.

Finally, further elements were suggested for further simplification and enhanced trust in the standard, unaltered nature of the contract. These elements include a mediation clause to refer to the newly created SEFA association as the custodian of the contract and mediator as the first line in conflict resolution, as well as the digital signature authentication that is being developed in PROPEL H2020, and potentially further enhancing the security level with blockchain technology (in form of a “smart contract”).

3.2 LAUNCH Risk Assessment Protocol

First Investor Board meeting (Nov 2019)

General feedback

The Risk Assessment Protocol was generally well received, and investors appreciated the standardized nature of presentation, which forces project developers to think through and provide risk-related information at an early stage in the project underwriting process. The credit risk assessment methodology was acknowledged as a first filter to flag any significant shortcomings in the financial standing of counterparties. However, investors will of course continue to rely on their in-house tools and expertise when assessing counterparties' credit risk in the detailed due diligence process.

Specific feedback on risk types

Regulatory risk

It was suggested to expand the regulatory risk section with a question on compliance with any relevant environmental or health&safety regulation.

Energy price risk

Investors are generally not willing to take on energy price risk. It is nevertheless important for them to understand the underlying assumptions on energy price developments. For ease of use, direct URL links to Eurostat and ECB sources are provided for energy prices and inflation rates.

Performance risk

Performance risk is a key risk category for Investor and often a bit of a "black box", as reliable information is often lacking in project submissions. The Performance risk section was extended with additional relevant factors (flawed energy audit, equipment malfunctioning) and levels are proposed for the sensitivity analysis, simulating over- or underperformance by 10% and 20% and its respective impact on project revenues.

Management risk

Investors have suggested to add Management risk as its own category. In subsequent versions of the RAP, a basic KYC procedure, with relevant documents was included. We expect more details to be added to the KYC procedure in the future.

Second Investor Board meeting (April 2019)

Occupancy risk

Changes in the standardized contract regarding occupancy risk led to adjustments in the RAP.

Change in Control risk

Similar to prepayment risk, a change in control of the building where the project-related assets had been installed represents a risk towards the recipients of project revenue. As there were specific clauses added in the LAUNCH Standardized Agreement to deal with this matter, adjustments were made in the RAP to properly reflect these clauses. In any case, it will be important to understand whether the Subscriber/Client is the legal owner of the building concerned, and if not, to understand the site lease and term in more detail.

Construction risk

In the first official version of the Risk Assessment Protocol, Construction Risk was not considered in more detail, as SEA projects were assumed to be securitized at a stage that they are already operational – which essentially would eliminate Construction Risk entirely. It is indeed in the interest of accommodating all financing stages and structures, that the LAUNCH consortium decided to include Construction Risk in the RAP, and discuss its key elements and possible mitigation measures. This would therefore not only allow refinancers, SPVs and capital market players to utilize the information contained in the RAP, but also first lenders or warehousing banks.

ESG risk

The ESG risk section is not yet defined in this version of the RAP and will be included in the third and final version to be submitted in October 2021. The LAUNCH Investor Board has seen the creation of a subgroup of members interested in the ESG topic and further sessions with the ESG subgroup will take place from November 2020 to March/April 2021. Fundamentally, the ESG approach for the RAP will follow the GRESB methodology , as proposed by a number of investor and contractor stakeholders, and will be fully compliant with the EU Taxonomy on Sustainable Activities.

Further Investor input collected in RP2 (November 2020 – October 2021)

Supply chain risk as a key risk type previously not included in the RAP was identified through a number of investor interactions, as particularly with the COVID-19 pandemic and its economic fallout, timely procurement and shipment of supplies, especially from overseas, has received much more attention by SEADs and investors alike.

The ESG risk section was included as a stand-alone section in the final version of the RAP. The LAUNCH Investor Board has seen the creation of a subgroup of members interested in the ESG topic and further sessions with the ESG subgroup members have taken place from November 2020 to July 2021. The ESG approach for the RAP follows the GRESB methodology , as proposed by a number of investor and contractor stakeholders, and seeks to ensure compliance of investments with the EU Taxonomy on Sustainable Activities. The list of ESG criteria provided by GRESB on Real Assets was internally reviewed and additional feedback was gathered from a number of LAUNCH Investor Board members as to the relevance of individual criteria contain therein.

Another risk type that received further attention and input was the Management risk section, where different investors felt that further details and checks needed to be added in view of KYC compliance, especially at larger institutional investors. While no further work was undertaken on this front within LAUNCH, the PROPEL H2020 project will develop a specific KYC module to address this need going forward.

As with the standardized contract, the RAP also started to be applied in real-life settings, not only by SEADs, but by financial players themselves. One investment fund started e.g. to apply the credit risk assessment methodology in the RAP across the pipeline of projects under review, another was keen to adopt the ESG questionnaire internally, as they previously hadn’t covered that topic area in their project reviews.

Finally, a general sentiment was expressed to make the standardized materials and information available in a digitally environment, which would not only allow ease of access, but also integration between various tools (e.g. KYC and financial spreadsheets with the RAP), and dynamically adjustable tools, depending on project size and technology. This digitalization work is also foreseen to take place within PROPEL H2020 and a first digital platform integrating all main LAUNCH materials will be available for testing by summer 2022.

3.3 LAUNCH Standardized Financial Spreadsheet

General feedback

There has been a fundamental misconception on the part of the participants about what providers of growth capital are looking for and the type of investor who provides such capital are. Often, participants did not understand that typically growth capital investors are not looking to establish a strategic partnership with the company, and view the company as an investment rather than a partnership. Several participants did not want to enter into this type of agreement with an investor, as they were rather searching for a strategic partner than a mere investor.

Specific feedback on the content and structure of the financial spreadsheet

One major issue investors deal with in regards to private equity finance is the lack of either a Financial Director or financial background of the CEO of the ESCo who understands the financial side of the business.

As a consequence, one of the changes that were implemented in this template was to add a Management Team Spreadsheet (which is linked to the Management risk category of the RAP): where each of the Directors need to be named (and confirm if they own shares in the company). The investor finances a Management Team, however if the Management Team does not own shares in the company, it might not have the same level of involvement as a Team that is connected/linked to the company via a shareholder structure.

Management

Gauging indications for a solid management team, is our core requirement for investability. How is this best proven?

A key indicator is the documentation that a company is on top of their regulatory filing and tax obligations.

1. Failing any of the above mentioned key corporate housekeeping measures point to either
    a. Gaps in management skills
    b. Financial trouble, as they can’t meet their tax obligations
2. The self-application process further shows us if the applicant is having the necessary financial skills and discipline on his management team.
    a. If the applicant is not able to provide timely and accurate answers this might again point to missing skills
3. Furthermore, this might become an issue in the reporting cycles further down the road, when one has already invested, and when the real work starts, so we want to know early on
    a. Are you able to follow a prescribed process?
    b. Are you willing to follow a certain rigor?
    c. Negative conclusions from the above will not be resolved by an equity investment but will accentuate and make reporting further down the road very time consuming and a source of dispute.

i. In further version we will build a timing device into the tool, which will follow the speed of uploading of the whole process, the expected outputs are
    - Preparedness
    - Ability, and
    - Focus

ii. Whilst not a key yes/no question, it will serve further down the line in the interview process as a potential question

Investors do not want to waste time on potential candidates if they are failing on these key hurdles.

3.4 LAUNCH Standardized Company Presentation

General feedback

During the event that was organised by the LAUNCH consortium, in late November 2019 in Brussels, the limited experience on the SEAD's side in pitching for equity was confirmed in the pitching session - "Lightning raise session – What does "Engaging with finance" mean in practice? During this session, Energy Service Companies (ESCOs), project developers pitched for growth capital or project finance to a panel of investors that provided live feedback.

During the event the numbers of companies that pitched was 7 all presenting a different technology from lighting to wind power and heat power. The pitching session was held in front of 6 investors representing 6 investment funds were totalling around 6 bn € in investment capacity such as Demeter Partners (France), SUSI Partners (Switzerland), Alternative Capital Partners (Italy), Aquila Group (Switzerland) and a few others.

Regardless of the experience of the SEAD's, vital information was missing throughout the pitching sessions such as:

- Amount they are asking for?
- Use of proceeds: what will the finance received be used for i.e. sales force, PR and marketing, technical staff, etc.?
- What are they willing to give investors for the amount they ask for?
- Present an accurate picture of the pipeline
- Clear financials presented: cash flows, IRR, etc.

4. Conclusion

The first 18 months of the LAUNCH project provided an iterative development and testing cycle on the four investment-related tools. The continuous interaction with the Investor Board members on all of these materials was an essential value driver to not only enhance the developed materials, but also to increase their credibility across the industry and their value for all stakeholders involved. The LAUNCH consortium continued in the remaining 12 months of the project to engage that highly experienced and motivated advisory group.

Several new investors and banks have joined the Investor Board during the project on their own initiative, having come across the LAUNCH work e.g. at industry events and panels, a clear sign of the continued value this sector is seeing in the work on standardized materials. Having seen investors take on the standardized project finance materials and integrate them into their internal procedures, or considering specific investment structures around them, was a further testament to the longer-lasting impact we can expect these materials to have in the future.

LAUNCH has really only laid the groundwork for the next H2020 action that was started back in June 2021. 20 Investor Board members signed letters of support for the follow-on project PROPEL H2020[2]. This new action will build on this movement and take the momentum one step further by looking to create a long-term, institutionalized solution to address these challenges: PROPEL H2020 will create the Sustainable Energy Finance Association (SEFA)[3], which will incorporate and carry forward the LAUNCH and PROPEL work well beyond the scope and horizon of H2020 project work. As one of the first key Deliverables, LAUNCH - and newly created PROPEL – tools will be digitalized and built into an IT platform allowing a more dynamic and integrated use of the tools, significantly enhancing the user experience, reducing complexity and time spent in getting trained in the use of the tools. These tools include the standardized EaaS contract, risk assessment protocol, financial spreadsheet, ESG and KYC modules, loan application guidelines, and more.

[2] www.propelh2020.eu

[3] www.sefaeu.org