Investment
Delivery Forum

Guide to green investing with Insurers

September 2024

idforum.org.uk

New research shows the UK needs over £1.3 trillion by 2030 to deliver on energy, transport, and housing infrastructure ambitions Investment sources are currently forecast to deliver a little over half of what is needed, leaving a £615bn shortfall* – most of which needs to come from the private sector.

The UK must continue to develop investment pipelines to drive growth and move to net zero.

The Insurance industry is actively seeking new green/productive projects to invest in.

* c.£265bn shortfall in public funding and c.£350bn shortfall in private investment to meet required levels. This is equivalent of a £75bn shortfall a year until 2030. The annualised shortfall in private funding to 2030 is over £40bn. The research was commissioned by the Association of British Insurers' (ABI) Investment Delivery Forum and conducted by Development Economics.

Contents

This document should be treated as indicative guidance and not as any form of financial advice. The Investment Delivery Forum does not accept any liability for reliance placed on this document.

This is a short introductory guide to assist officials in Local and Combined Authorities, Housing Associations and regional partners who are looking to raise funding from institutional investors for green infrastructure projects.

It focuses on using Insurers as a potential source of funding and details some of the specific requirements of Insurers when they are making investments.

This guide will be helpful if you answer yes to any of the following questions:

1. Are you considering building green infrastructure and are seeking funding?
2. Are you less familiar with the role of Insurers as a source of funding for green infrastructure projects?
3. Do you want to understand what Insurers will be looking for when selecting which projects to invest in?
4. Are you ready to engage with Insurers and would like to know which Insurers to approach?

Why are insurers actively seeking projects?

Changes to the insurance regulatory framework are due to be fully implemented in 2025. Known as Solvency UK, these changes will help unlock £100bn in productive investment over the next 10 years by expanding the types of investments that the insurance industry can participate in.

As a result, Insurers are seeking suitable projects to count towards the £100bn.

Which Insurers are involved?

Established by the Association of British Insurers (ABI) in July 2023, the Investment Delivery Forum (the Forum) was created to ensure industry readiness to invest in a greater range of **infrastructure assets***.

What do we mean by Green Infrastructure?

We define green infrastructure, in very broad terms, as projects which:

- Expand **productive capacity***,
- Further **sustainable growth*** and
- Contribute to **the real economy***.

As a starting point, insurers are looking for projects that fit within these broad terms. Real examples include wind or solar power farms, large scale housing projects, energy networks such as EV charge points, hospitals or care facilities or electric vehicle fleets.

Note: These criteria are based on the work of the Productive Finance Working Group established by the HM Treasury, and Bank of England and the FCA in 2021.

* Please refer to our '**Definition of terms**' on page 21

Are Insurers a plausible source of funding for your project?

Does your project fit within what we mean by Green Infrastructure?

Yes

Then the next step is to consider the other factors Insurers will be looking for when selecting which projects to invest in?

The Insurance industry is typically an ideal investment partner when the projects meet the following five conditions:

1. Project is of investment grade (or equivalent)
2. Cashflows run over a long-term duration
3. Cashflows generated from the project are predictable/stable
4. Investment yield is attractive compared to alternative long duration assets
5. Efficient end-to-end planning processes are in place

No

Yes

Unsure

Insurers are a plausible source of funding: You should investigate

No

Have you considered other sources of funding?

Insurers invest on behalf of pensioners, whether that is defined benefit, defined contribution or for annuities. Regardless, insurers are very mindful that they need to invest carefully and wisely with people's life savings.

For annuities, debt financing is used which allows for a predictable return over a long period of time. Insurers as annuity investors will look at the following:

Project is of investment grade (or equivalent)

When a project is of investment grade (or equivalent), it means that it is deemed to be a relatively low-risk investment opportunity. The designation is typically assigned by credit rating agencies or Insurers' internal credit rating model.

Cashflows run over a long-term duration

Insurers favour projects that generate revenue for many years (typically more than 15 years). The long-term nature of the cash flows provides predictability in returns.

Cashflows generated from the project are highly predictable/stable

Projects with predictable/stable cash flows indicates there is a high degree of certainty regarding the amount and timing of cash flows associated with the projects. These projects are attractive to insurance investors because they offer a level of assurance in the projects' ability to generate consistent returns.

Investment yield is attractive compared to alternative long duration assets

Insurers will seek to maximise the value of the annuities they can provide to their customers. Lower yielding projects with similar risk profiles and investment durations are usually discounted.

Efficient end-to-end planning processes are in place

Inefficiencies or delays in planning can make projects unattractive compared to alternative investments that Insurers can make. Projects should have well-defined processes spanning the entire project lifecycle.

When to engage with Insurers and what to expect

It takes a lot of work (and a long time) to go through the entire process from the original concept through to operating the infrastructure. And it is the case that many of the steps in the process will already have happened by the time you start to engage with Insurers for debt financing.

Breaking down the investment journey of a typical infrastructure project into steps will help you navigate the complexities of investment decision-making and be better placed when you are ready to engage with Insurers about them providing funding.

Proposition discovery is a key step and opportunity to demonstrate to the Insurers the compelling nature of your project.

Typical steps that happen before you engage with Insurers

- Site identification/acquisition
- Initial project planning (scoping/feasibility) and due diligence on parties involved
- Obtaining the necessary planning permissions and permits (e.g. zoning, building codes, environmental standards)
- Securing any agreements with counterparties (e.g. contracts between developers and buyers or tenants)
- Preparing the financial plan (projected costs, revenues, cashflows, financial risks & mitigation, funding sources)
- Financial structuring – determining how the investment will be funded including the mix of debt and **equity*** used to fund its development, construction, and operation.
- Sourcing equity investment
- Hiring any necessary sub-contractors (e.g. ranging from construction and engineering to maintenance services)

Commons financial structures

- Blended finance models mean different investors with different risk appetites can come together to fund high impact projects. Bringing in public funds into the mix lowers the risk to those investors and allows insurers (annuity investors) to take part. This gives local authorities, housing associations and other government bodies access to a larger pot of money for projects.
- Special Purpose Vehicles (SPVs) are legal structures that allow investors and local authorities to pool their financing for a project. Using SPVs can offer participants confidence that financial risks are isolated in one place, and any external shock on another investor will not result in any unplanned/legal withdrawal from the pool.

Typical steps that happen as you engage with Insurers (for debt investment)

- Proposition discovery – sponsors walk the insurers through the project concept, how it works, the financial assumptions and risks
- Financial structuring – determining how the investment will be funded including the mix of debt and equity used to fund its development, construction, and operation.
- Sourcing debt investment
- Identifying and agreeing on the roles and responsibilities of the different parties (e.g. the project sponsors, lenders, equity investors, contractors, **off takers*** and advisors)

Typical steps that happen on the Insurer side

- Diligence: assessing the investment's risks and potential returns (across key components such as financial diligence, legal diligence, technical diligence, market diligence, environmental and social diligence, and operational diligence.
- Gaining regulatory approvals (e.g. for a specific asset to be used in the calculation of the Matching Adjustment (MA) for insurance liabilities, authorisation need to be granted by the Prudential Regulation Authority (PRA).

* Please refer to our '**Definition of terms**' on page 21

Examples of projects funded by Insurers

To get a good flavour of what opportunities are available when working with insurers as investors, here is a selections of real-life examples from each of the Investment Delivery Forum firms of projects already invested in.

JUST.

£22m to support Bromley Council help tackle homelessness

In 2020 and 2021, Just provided £22m of funding to Bromley Council to help the council meet its statutory obligations on homelessness and reduce the financial pressure of Bromley providing costly temporary accommodation.

The deal started in August 2020, with the first tranche of funding being given in November 2020 and a second in June 2021, with the transactions being done via a SPV.

The SPV used the funding to acquire 50 social housing units from a housing association, which the SPV then leased to Bromley on a 135 year triple-net lease.

The investment is a debt instrument over 50 year maturity, with **amortising repayment structure***, linked to Retail Price Indicator for inflation and is **senior secured***.

Those involved in the process were the London Borough of Bromley, the housing association that disposed of the assets and Just's external asset manager. The external asset manager assigned an internal rating to the asset of AA-.

* Please refer to our 'Definition of terms' on page 21

£50m in funding for mixed use properties project with Stevenage Borough Council

Aviva came in as the funder of the project after the Developer, Reef Group and Stevenage Borough Council had already achieved planning. The transaction between parties took six months to close from that time.

Aviva bought the land and provided the finance to the developer and contractor to refurbish the retail and office spaces and build 120 new residential units on the site.

Once this stage was complete, the asset was leased back to the local authority, who then sub let this to a mixture of retail, office and residential tenants.

The lease structure is fully amortising*, so the asset reverts back to the local authority at the end of the lease for a notional sum. The duration of the loan is 35 years.

Those involved in the process were Aviva as the funder, Reef Group as the developer, and Stevenage Borough Council as the tenant. There was also a real estate advisor supporting the local authority.

The asset was rated internally by Aviva.

* Please refer to our 'Definition of terms' on page 21

Rothesay

£30m debt investment in Welsh Housing Association

In January 2022, Rothesay completed a £30m debt investment in Adra Housing (Adra Tai Cyfyngedig), which followed an initial investment of £50m with Adra back in December 2019.

The funding provided by Rothesay helped to create social value within local communities in Northern Wales by supporting the development of 180 new homes per year as part of Adra's long-term development strategy.

The new homes funded by the investment have been earmarked to meet strict energy efficient standards, with a minimum EPC rating of 'B'. (The majority have achieved an EPC rating of 'A'.)

Proceeds of the loan also went towards the opening of a decarbonisation centre in Penygroes. Once fully operational in 2023/24 Tŷ Gwyrddfai will become a dedicated facility for training in low carbon technologies, upskilling for retrofitting and green technology innovation, including research into decarbonisation materials.

As typical for borrowing in the social housing sector, the borrower used an advisor. The loan did not obtain external rating, and no local authority was directly involved in the project.

£65m of funding to support the delivery of c.1,000 new affordable homes across Scotland

Scottish Widows provided £65 million to support the delivery of c. 1,000 new affordable homes in Scotland for Dunfermline-based LAR Housing Trust. The finance was to support the creation of a portfolio of high-quality homes for mid-market rental.

The deal started in July 2017 with Scottish Widow providing a fixed rate loan term of 23 years. With LAR Housing also obtaining a subordinated Scottish Government loan, the deal was rated internally.

Those involved in the process were LAR Housing Trust, Scottish Government and Scottish Widows.

Phoenix

£50m investment to deliver 1,000 energy efficient homes in Wales

In 2021, Phoenix Group invested £50 million to deliver 1,000 energy efficient homes in Wales. The borrower Welsh Housing Association was looking for long term financing to develop 1,000 new energy efficient homes and help tackle the housing shortage in the UK.

The investment is a debt instrument of over 30-year maturity. From initial approach to execution, it took less than a month to close the transaction.

The deal was structured as a bullet debt profile (a type of debt repayment schedule where the borrower pays off the entire principal amount of the loan in one lump sum at the end of the loan term) with a portion of the total funding amount in deferred format to best suit the Welsh Housing Associations' business plan.

The borrower used an advisor however the asset did not need to obtain an external rating and no local authority was directly involved in this project.

£60m of debt financing for two residential regeneration projects in Wales

Between 2020-2024 M&G provided over £60m of debt financing for two residential regeneration project of c. 500 energy efficient and largely affordable rent properties in Wales, drawn down in five tranches.

The financing was a tripartite collaboration involving public and private capital to advance landmark regeneration schemes in areas of high demand for affordable and social rent accommodation.

The projects do not only extend the provision of accommodation at submarket rents, but also create more inclusive communities due to a mix of tenures. At the same time, they benefit local economies by creating employment opportunities. All properties are built with the highest energy efficiency levels (EPC A and B).

The investment is a debt instrument over 50 year maturity, with amortising repayment structure* linked to inflation and is senior secured*. It was not rated externally but was rated investment grade internally at M&G.

Those involved in the process included Welsh Government, advisors and M&G.

* Please refer to our 'Definition of terms' on page 21

Other investment opportunities

As previously noted, insurers invest on behalf of current and future pension holders. While the Forum revolves around annuity providers and the opportunities of debt investment, there are a broader range of insurance investments made by members of the Association of British Insurers.

Here are examples of what can (and is) being invested in, using equity. If you are interested in finding out more about this please do contact us.

£15.7m invested in Care Home development in Milton Keynes

Royal London is seeking to invest in UK healthcare real estate in a sustainable and impactful way, to generate attractive, income-driven financial returns.

The company's healthcare investment programme represents a major new institutional entrant to the sector. Since conception in 2022, the programme has committed almost £240m across 17 care homes, delivering 1,134 modern care home beds into undersupplied markets across the country. The development of strong relationships with both developers and specialist operators provides access to an ongoing acquisition & development pipeline.

The soon to be completed 'Applewood' in Milton Keynes will provide 78 bedrooms and extensive communal facilities for elderly residents. The home is being built to a highly sustainable specification with some revisions to the design following engagement with the local planning officer. Discussions on the transaction began in 2022 before completing on the land and Forward Funding Agreement in February 2023. The development is due to complete in Q4 2024. It was financed through 100% equity.

The care home will be leased to a specialist For-Profit care operator, who provide care to residents from both the local authority and privately funded markets

A number of specialists advised on the transaction, including a land agent, building surveyor, architect, solicitors, sustainability consultant, clinical assurance specialist and financial advisor.

Financing for acquisition of Hornsea Two offshore transmission assets

Started in Q1 2022 Aviva successfully completed a 24-year senior debt financing for acquisition of Hornsea Two offshore transmission assets. The bidding competition for the Offshore Transmission (OFTO) took ~14 months to complete.

Offshore Wind development is a key pillar of the UK Government's decarbonisation policy. To address 'unbundling' requirements, regulation requires separate ownership of transmission and generation assets. The OFTO competition following construction completion facilitates ensuring the transmission asset is sold to a different entity to the generation asset.

The growth of OFTO and Offshore Wind private finance has been strongly supported by Government through the development of dedicated financing structures for OFTOs. The project is funded by equity and senior debt. The funders comprised of leading institutional investors, banks and export credit agencies. There is no construction risk as the asset is only transferred upon completion.

Revenues are on an availability basis, indexed linked, with unavailability deductions capped at (-10%) p.a. Project documentation and regulatory regime are well established and predictable. Overall, this structure supports a low risk, strong investment grade rating for senior debt.

Attractively the OFTO's revenue stream is fixed (Tender Revenue Stream (TRS)) upon ownership transfer for licence term and subject to indexation which supports indexed linked debt solutions.

As typical for a project financing of this scale there would be a suite of advisors including a financial advisor, legal, technical/production, insurance and model audit who provide an independent assessment of the various facets of the deal to support lenders' credit assessment.

The asset was rated by Aviva using its internal model, mirrored on a methodology from an established rating agency. The debt achieved an investment grade rating and provided attractive long term indexed linked debt for their annuity client.

£250m of debt financing for the refinancing of a portfolio of solar projects in the UK

M&G provided £250m of index linked debt financing for a c.100MW portfolio of UK solar parks, which has been used to refinance the portfolio and release equity to be reinvested in the development of new solar projects in the UK.

The revenue was underpinned by the UK's Feed In Tariff regime for solar, mitigating against power price volatility and delivering a more steady stream of cashflows to finance against.

The deal started in 2017 Following a 6 month discussion from the initial approach to its execution. The 22 year term loan involved a mix of debt, equity and mezzanine given to a leading European solar developer, with which M&G has a long standing relationship. It was rated investment grade internally.

Those involved in the process included various advisors, the sponsor, M&G and mezzanine lender.

Definition of terms

Page	Term	Our definition
5	Infrastructure assets	Physical structures, facilities, systems, and networks that provide/support essential public services
5	Productive capacity	The ability to make profits and improve cash flow
5	Sustainable growth	E.g. supports net zero
5	The real economy	The part of the economy related to businesses that produce and distribute goods and services
9	Equity	Buys a stake in the project
9	Off takers	Who buys the final product (e.g. electricity generated, tenants for homes)
11/16	Amortising repayment structure	Meaning regular payments, and the asset going back to the borrower after the end of the lease
11/16	Senior secured	Backed by assets/collateral in the event the borrower defaults
12	Amortising	Paid off over time

Investment Delivery Forum

Want to get in touch?

Please contact the Investment Delivery Forum by email at idf@abi.org.uk