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A place in the sun: investing in solar farms

According to a tweet from the National Grid, Friday 21 April 2017 was a landmark day because, for the first time in more than 130 years, Britain functioned as normal without turning on its coal-fired power stations. The country's daily electricity came from a combination of gas power plants (47%), nuclear plants (18%), wind farms (18%), solar panels (10%) and biomass (6%). Renewable power is an increasingly important part of our energy infrastructure. This article describes the current market for one element of the renewables sector; solar farms.

Overview of the solar farm industry

Solar farms are greenfield or brownfield sites fitted with photovoltaic solar panels and ancillary equipment, which are connected to the electricity grid. In 2010 there was a rush to develop solar farms in order to take advantage of the generous government subsidies, such as feed-in tariffs ("FITs") and payments under the renewables obligation ("RO") scheme, which could be claimed by eligible renewable energy generators at that time. These subsidies have been progressively scaled back (and, in the case of the RO scheme, closed) to new generating capacity over time, leading some observers to predict a decline of the UK's solar industry.

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However, the cost of photovoltaic panels has fallen significantly in recent years, which means that second generation solar farms are cheaper to assemble and therefore still a good investment despite lower subsidy levels.

Additionally, recent advances in battery storage technology means that combined solar and battery farms are becoming increasingly attractive. Such installations enable energy to be exported to the grid even when the sun is not shining or at times of peak demand, so generators are better able to match supply to demand and enhance revenues.

Also, the first generation of solar farms are still in operation and still benefitting from the original FITs rates (usually under 25 year contracts) so there is a thriving market for the onward sale of these real-estate backed investments.

WHAT ARE THE CURRENT HOT TOPICS IN THE SOLAR FARM MARKET?



The topics of current interest and concern to investors in this market include:

- Battery storage advances – these are already helping cut the intermittency of solar output and allowing solar assets to produce during peak electricity pricing periods.
- Business rate increase – there is concern in the industry that the economic viability of commercial rooftop solar installations could be dented by increased business rates.
- Competition for sites especially if more residential building is permitted on greenfield land following the government's recent housing white paper which is perceived as having heralded a loosening of the restrictions on housing developments in such areas.

Why are solar farms an attractive real estate investment?

Solar farms have become an appealing real estate investment class in their own right for the following reasons:

- 1.** The current shortage of more traditional infrastructure investment opportunities - for instance, there are at present very few PFI/PPP projects taking place in the UK.
- 2.** Reliability: the annual variability of solar radiation levels is just 4% (in the UK), lower than wind variability.
- 3.** The stable yield received on these investments, due to their dual income stream – the proceeds of the sale of the power generated (with the added benefit of operators knowing how much they will get for each MW/hour generated) and, where available, subsidies. Their low set-up and maintenance costs increase their income stream stability. The life span of solar panels is generally 25 years, but they can last up to 40 years if properly maintained.
- 4.** Solar funds offer returns that are not correlated with the equity markets: their dividend yields are therefore useful in times of high market volatility.

Legal issues to be aware of when investigating the suitability of a solar farm for purchase or refinancing

- 5.** Title
 - A.** Agricultural land is sometimes unregistered. This makes it much harder to review ownership and to determine the existence of third party rights.
 - B.** Such land is also sometimes subject to agricultural tenancies or farming partnerships, which can be complicated and can involve some security of title issues.
 - C.** There might be separate third party rights such as rights for the grazing of sheep.
 - D.** Is the land charged? If so, bank consent to the arrangements will be needed.
 - E.** Have wayleaves been granted for power cables to cross third party land?
 - F.** Check there are no rights or reservations which restrict rights of light over the property.

- G.** There should be boundary agreements with neighbouring landowners (this may be the landlord on whose land the solar farm is located, and/or others). These are likely to include non-interference

obligations on the part of the landowner so that, for instance, they cannot grow trees above a certain height, along with a right for the solar operator to go into the neighbouring plot to trim hedges and trees and to deal with any other issues that might affect the functioning of the solar farm.

6. Planning consent

- A. Check that there is a planning consent and that it has been properly implemented.
- B. Has the capacity permitted by the consent been exceeded?
- C. Check that the consent includes any ancillary works such as battery housings, cables etc.
- D. Consents are normally temporary, so check that its lifetime is adequate.
- E. If it is nearing its expiry, consider making a new application to replace the expiring one which can accommodate any further development, upgrade for alterations etc. Remember that there will be a requirement to remove all structures on expiry of an old consent if not renewed.

7. Renewable incentives

- A. Check RO/FIT status of project (where relevant)

8. Contracts to be checked and reviewed:

- A. There will usually be an option agreement and/or a lease with the landowner which will need to be reviewed. If one of these arrangements needs to be varied or renegotiated then this can be a time-consuming process if the landowner is unused to negotiations of this sort. There is no industry-wide accepted form of option or solar farm lease which means that each one is bespoke. They will often contain potentially large decommissioning/reinstatement costs for solar farm tenants at the end of the term of the lease, in respect of which many landowners will require collateral/security (often in the form of a performance bond) to cover the risk.

Leases may also contain step-in rights for the funder, often in the form of a "direct agreement" (which is sometimes annexed to the lease and sometimes entered into on the same date as the lease) under the terms of which if the tenant defaults then the funder takes over the relationship with the landowner and the running of the solar park.

- B. EPC contract which may include the following details: level of insurances (such as property, employer's, public liability, professional indemnity and product liability insurances); FIT or RO accreditation (to get subsidies, if available); defects liability period following completion/acceptance; manufacturers' warranties for panels and equipment such as the generator; provision of spare parts; collateral warranties/third party rights and/or performance bonds; completion tests; guaranteed availability; performance and delay liquidated damages; and limitation period.
- C. Operation and maintenance contract, which may include the following items that need to be checked: term; level of insurances (such as property, employer's, public liability and professional indemnity insurances); services may include commissioning, reporting, monitoring, analysis and diagnosis, preventative/corrective maintenance, spare parts management; performance ratio liquidated damages; collateral warranties/third party rights and/or performance bonds.

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D. Grid connection agreement:

- Is there a valid connection offer and acceptance?
- Is an adoption agreement required and in place?
- Is a metering agreement in place?
- Have the grid connection capex costs been discharged?
- Are there any known or anticipated grid outages?

A strong long-term option

Despite the dwindling government incentives and potential returns for new solar farm projects being less attractive than they have been in previous years, the market for existing solar portfolios as an alternative asset class remains attractive. Additionally, new build combined solar and battery storage project are likely to become increasingly popular as technology becomes more established. Long-term, stable yields with relatively low operational costs makes this an appealing asset class for a range of investors, particularly those such as pension funds looking for a long term hold. There is also the added appeal of investing into a sector which is reducing our carbon footprint.

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