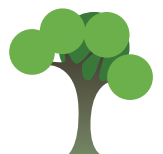


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Integreat Yorkshire, growing people's skills to make great places

The road to recovery briefings:

Briefing 4: Getting the structure right – is social enterprise the solution?



Introduction

Choosing the right structure for a community-based energy project is critical to its success.

No single model is right for everyone, and a number of project-specific factors must be taken into account including the scale of the scheme, potential sources of investment and how the benefit is to be passed to the community.

For smaller projects costing under £1m, an Industrial and Provident Society (IPS) has become the vehicle of choice.

There are over 8,000 Industrial and Provident Societies in the UK with a total of 10 million members. Their growing use in local sustainable energy developments has demonstrated the potential for raising significant capital from the community, offering a financial and social return.

An IPS can be run as a co-operative for the mutual benefit of its members, with the profits ploughed back into the organisation or used to benefit the community as well.

Societies can issue community share offers at relatively low cost by structuring them to avoid the costly red tape of a full public prospectus.

Giving local people a financial stake in the organisation can drive the project forward, increase support for planning applications, lead to greater social cohesion and promote awareness of the importance of renewable energy – often a key aim of schemes, in addition to generating power.

Projects worth more than £1m may justify the issuing of a prospectus through an IPS or a public limited company (PLC).

This will cost around £100,000 to administer, but it has the potential to raise far more investment as the share offer is open to the general public.

Using a PLC sacrifices the co-operative principles of an IPS in return for the prospect of additional investment. There is no limit on the outlay by any one shareholder and voting power is commensurate with the number of shares held.

If the project has been structured so that the renewable energy developer pays a portion of its profits to the community, a community trust may be the best model to distribute this money to local projects.

Alternative models for the local energy sector include community interest companies (CICs). These can be limited by shares or by guarantee but must be set up to benefit the community.

A central principle of CICs is an 'asset lock' which ensures the assets remain in the community. This places a cap on dividends and on the percentage of profits that can be distributed.



There is no limit to the amount of profit a CIC can make, and this profit can be distributed to members, which may encourage investors who will also get a vote for every share, unlike an IPS.

Alternatively, projects could set up as charities. These have the advantage of being readily recognised, they attract support from funders and supporters, and income is not taxable.

But to achieve charitable status a community renewable project would have to supply energy for a charitable purpose, such as for a school or hospital. This is likely to severely restrict charities' role in this sector.

Recent developments

Recent research has highlighted the wide-ranging benefits of using of an Industrial and Provident Society (IPS) structure for the renewable energy sector.

Reports by the Department for Business Enterprise and Regulatory Reform (see links, below) show that the IPS model works well in community renewables. Similar research, not yet published, has been undertaken by Future Energy Yorkshire (FEY).

This model has paved the way for millions of pounds of investment through community share issues and motivated communities to actively support projects, as well as promoting education and awareness of clean energy generation.

Energy4ALL has pioneered the use of IPS legislation in developing community owned wind farms. It offers relatively high rates of returns to investors, with some schemes forecasting a 12% annual return.

The co-operatives developed by Energy4All have issued transferable share capital so members are free to sell their shares.

This requires the publication of a prospectus, and falls under the regulations of the Financial Services and Markets Act 2000 (FSMA). As the costs of the issue are around £100,000, the share offer should seek to raise over £1m.

Using the IPS model maximises democracy as one member has one vote regardless of investment size. However, there is a limit of £20,000 on investments, which can hamper efforts to raise the large amount of funds needed.

Risks can be reduced if specialist lenders are prepared to underwrite a share offer. Key Fund Yorkshire, for example, which lends mainly to social enterprises, has underwritten some community renewable share offers.



Energy4All's approach has been replicated in smaller scale projects by Water Power Enterprises (H2oPE), a community interest company (CIC). It develops hydro-electric schemes which require relatively low capital outlays of around £300,000.

H2oPE has created community benefit societies and issued withdrawable share capital, which exempts it from FSMA regulations. This means it can run a share offer at much lower cost, which is crucial given the smaller scale of its schemes.

CICs, introduced in 2005, are intended to be easy to set up, with the flexibility of a company and 'light touch' regulation.

They operate more commercially than charities, though without the tax advantages. To ensure that they are operating for the benefit of the community, they have features such as an asset lock, a dividend cap and a 'community interest' test.

Legislation also allows community benefit societies, but not co-operatives, to introduce an asset lock. A lock can be a key influence on an investor's judgement about the financial and social return being offered.

CICs must submit an annual community interest report which sets out how their activities have benefited and involved the community.

As they are recognised as serving the interests of the community they may have increased opportunities for fundraising and public support. They can raise money through loans, grants, and donations, and have limited access to equity finance.

Unlike IPS structures, there is no requirement for a CIC to have a democratic structure.

Research for the Sustainable Technologies Programme (see link) found that while no single model could be recommended, projects led by local people or existing community groups had the most chance of success.

FEY has developed a simple decision tree (see link) to evaluate which structure is right for particular circumstances.

Case study - Kielder Community Enterprises Ltd

Money may not grow on trees, but one of England's most remote villages is gaining cost savings and environmental benefits from nearby forests.

A district heating system, using a ready supply of wood from local forestry residues, is warming new homes and community buildings in Kielder, Northumberland.

As well as cutting carbon dioxide emissions, the project has significant financial advantages, as the village is not connected to the mains gas supply and heating systems have to run on oil or electricity.



Kielder Community Enterprises Ltd (KCEL), a trading arm of local community charity Kielder Ltd, manages the wood-fired district heating scheme. It set up an energy services company (ESCo) in 2004 with the help of external advisers.

Both Kielder and KCEL are not-for-profit companies. Any resident can become a shareholder and all board members are elected by local people. KCEL also owns a garage, manages a campsite and some workshop units, and runs a community bus service.

The heating project was set up to reduce energy costs and carbon emissions and to support the financial sustainability of KCEL.

It also aims to safeguard forestry jobs and support sustainable forestry by developing new sources of income, and raise awareness of renewable energy opportunities by developing a pilot village biomass district heating scheme.

KCEL worked closely with Tynedale Council, Northumberland County Council and Forest Enterprise, which manages the national forests on behalf of the Forestry Commission.

It did not feel confident in taking on the whole risk of the initial investment and Tynedale Council, which initiated the project in 2002, agreed to underwrite it. The total installation cost was around £650,000.

Funding came from the European Regional Development Fund, Northumberland Strategic Partnership through regional development agency One NorthEast, Northumberland National Park Authority, Powergen's GreenPlan fund, The Forestry Commission, Northumberland County Council and Tynedale Council.

The 300kW boiler, officially opened in June 2004, has an energy efficiency of around 87% and saves around 57 tonnes of carbon dioxide emissions per year compared with the use of heating oil.

The boiler uses between 250 and 450 tonnes of wood per year, supplied by Forest Enterprise, and provides heat and hot water to Kielder Castle visitor centre, six new affordable homes, workshop units, a school and a youth hostel.

It is hoped all running costs will be covered by the income from sales. Kielder has now become a working demonstration site for biomass.

Expert view: Dave Thornett, chair, Social Enterprise Yorkshire and the Humber

Selecting the right structure is not straightforward. There is a range of legal models you can use, both as stand-alone legal entities and in combination to create trading subsidiaries.



Navigating through the options can be confusing, but in choosing the right legal structure, form should always follow function.

If you need to knock a nail into a wall choose the right hammer rather than settling for the end of a big screwdriver because it came to hand.

Ask some simple questions to help you on your way - what are you going to do, how are you going to do it, who is involved, how are they involved and what do each of the stakeholders expect to achieve or gain through their involvement?

Answering these questions can help to narrow down the options by matching your requirements against the basic characteristics of each legal status, allowing you to explore the best matches in more detail.

The main requirements for community renewable enterprises are to raise money and to engage and retain the involvement of the community. Your legal structure needs to enable both these things in a way that is appropriate to your circumstances.

Dealing with renewables usually means capital investment and subsequently a constitution which will allow for loans, equity or a share issue.

The two legal structures which perhaps provide the best fit are companies limited by shares, and Industrial and Provident Societies.

A straightforward share capital company is quite flexible, but is still unusual in the sector and can be regarded with caution by social investors. However Cafédirect managed to raise £5m in 2004 from an ethical share issue which saw it become a PLC.

Adopting community interest company status introduces an asset lock and a community interest test which can help allay any concerns.

CIC status also brings a set of regulations, including a maximum dividend per share (currently 5% above Bank of England base rate) and a dividend cap limiting distribution to 35% of distributable profits. CICs do not enjoy any special tax status.

This leaves the Industrial and Provident Society - a one member, one vote structure, which I believe provides the best fit.

A study on the use of the IPS structure in community investment for Cooperatives UK, written by Jim Brown in 2008, sets out a very convincing argument for its use as the best model for genuine community engagement and investment.

An IPS provides a less expensive source of money than bank lending, reinforcing the link between the community and the business, and creating share capital that can act as security to lenders.

In addition, the issue of withdrawable share capital by IPSs is not subject to FSMA regulations, so societies do not have to be authorised by the Financial Services Authority to issue it.



Checklist

1. Understand the importance. The structure you choose could determine the success or failure of your scheme. You need to make the right decision early in the life of the project.
2. Consider all the options. There is no single model structure for community energy projects. Understand the pros and cons of the different choices open to you.
3. Select the structure that best fits your project's needs. Take account of the scale and nature of your scheme, where you expect funding to come from and how you want the community to be involved and benefit. Give close consideration to the tried and tested Industrial and Provident Society model which can be used to raise funds through community share issues. Remember that greater community involvement generally results in more successful projects.
4. Get help. You will need expertise to decide on the right legal structure and to set it up. Explore the links below to find out more about the range of help available. A number of co-operative organisations will be willing to assist you and provide free advice. Specialist renewable energy organisations such as Energy4ALL and H2oPE can help communities develop IPS structures.

Find out more:

National guidance and advice

www.berr.gov.uk – Department for Business Enterprise and Regulatory Reform. Includes Reports on Bankable Models Which Enable Local Community Wind Farm Ownership and Delivering Community Benefits from Wind Energy Development: a Toolkit.

www.cooperatives-uk.coop – Cooperatives UK. News and advice on co-operatives including 'five steps to starting a co-operative,' and information on co-operative CICs. Includes the report, Community Investment using IPS legislation.

www.cicregulator.gov.uk - Community Interest Company Regulator. Advice and resources on setting up and operating CICs.

www.dta.org.uk – Development Trusts Association – a leading network of community enterprises.

Help in the Yorkshire and Humber region

www.seyh.org.uk - Social Enterprise Yorkshire and the Humber. Advice and support for social enterprises.

www.fey.org.uk - Future Energy Yorkshire's funding decision tree (search for 'funding tool').



www.keyfundyorks.org.uk - Key Fund Yorkshire: loans and equity investment for community-owned businesses.

Other useful information

www.sustainabletechnologies.ac.uk - The Sustainable Technologies Programme (STP) is a major research initiative by the UK Economic and Social Research Council. Includes Harnessing Community Energies briefing.

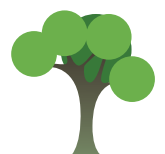
www.co-operativefutures.coop - Co-operative Futures. A range of resources, case studies and links to support organisations, including a comparison guide to different social enterprise structures.

www.trusteenet.org.uk/files/Governance%20and%20Organisational%20Structures.pdf - Co-ops UK guide on legal structures.

www.energy4all.co.uk - Energy4All. Helps communities develop

wind farms, using IPS community investment. Includes a step-by-step guide to establishing a community wind project.

www.h2ope.org.uk - H2oPE. Specialises in helping communities develop hydro-electric schemes through co-operative models.



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