Q&A with the Investment Adviser

Philip Kent
CEO, Investment Adviser

Capital allocation policy

Q Do you expect to fully execute on the targets laid out in the capital allocation policy, and what is next for the Company once it has completed its stated aims?

To facilitate the aims of the policy, the Investment Adviser has been focused on executing disposals and refinancing processes to realise the £150 million capital target. The Company's disposals total £38.2 million at the end of 2024, with a pipeline of additional disposals in excess of £150 million. We have experienced consistent delays across transactions throughout the year, with processes taking longer than expected across all sectors. However, the Board and the Investment Adviser remain committed to achieving the stated aims of the capital allocation policy as quickly as possible.

The capital allocation policy was developed in conjunction with shareholders to help address the disconnect between share price and NAV. Once the Company has executed on the stated aims of the policy, the Board will re-evaluate its position based on the price at which shares are trading. If there is a material discount[1] thereafter, the Board will evaluate the merits of continuing to return capital to shareholders against the risks of decreasing the Company's scale. Nevertheless, we, and the Board remain optimistic about future investment opportunities.

The new Government has made encouraging commitments to decarbonisation that will require significant investment across the UK. A heightened interest rate environment also offers the opportunity to take materially reduced risk to achieve the same level of return or capture elevated returns from new technologies that will form part of the Government's decarbonisation mandate.

Investment opportunities

Q Where does the Investment Adviser see attractive opportunities in the UK infrastructure market?

The UK infrastructure market finds itself in a far better position than it was at this time last year, with aggressive ambitions for deployment of renewables: 60GW offshore wind, 50GW solar photovoltaic, 30GW onshore wind and 10GW of low carbon hydrogen capacity, and decarbonisation of the electricity grid by 2030. This comes alongside policy support in a number of new sectors, including a cap and floor scheme for long-duration energy storage, and ambitions for four industrial carbon capture and storage clusters sequestering 20 to 30 million tonnes of carbon dioxide per year by 2030.

The Company is well placed to benefit from a transitioning subsidy landscape, and has a track record of being an early-mover in new sectors, particularly through its focus on debt. Significant policy developments will be required in the next decade to support widespread decarbonisation across existing sectors (wind and solar), but also across a broad spectrum of industries including heat, transport, industry and agriculture. There are attractive opportunities to benefit from enhanced returns in new technologies before yields compress, which is an approach the Company has a legacy of executing. Fundamentally, the ambitions stated will require levels of investment that have not previously been seen, and this will stretch liquidity in the market, providing further investment opportunities for the Company.

1. APM – for definition and calculation methodology, refer to the APMs section on pages 170 to 172.

Share price performance

Q What do you believe has caused the disconnect between share price rating and NAV?

There are several reasons for the discount[1] between the share price and underlying NAV. One of the most significant reasons is the current interest rate environment, as increases in base rates have fed through to discount rates, which has caused valuations to decrease. This has increased the cost of debt, with many investment companies relying on leverage for capital deployment programmes and to enhance returns. At the same time, investors have seen an attractive opportunity to reallocate into traditional fixed income such as government and corporate debt.

We now find ourselves in a position where central banks have started to cut interest rates, and we hope that as this progresses the relative attractiveness of listed investment companies increases.

The increased interest rate environment has highlighted areas of stress within some investment companies, where shareholders have focused on valuations, highlighting a lack of uniformity in methodology. In a handful of isolated cases, flaws in certain approaches have caused contagion across a whole asset class, such as social housing and battery energy storage.

Cost disclosure

Q Can you explain the legacy of double counting in cost disclosure, and what recent developments mean for investment companies?

In the United Kingdom, the Financial Conduct Authority ("UK FCA") is responsible for implementing regulations to ensure a financial product is transparent when disclosing the costs associated with investing. These costs can include fees for fund management, transaction costs or the charges of underlying assets. The aim for cost disclosure is to provide investors with a clear view of how much they are paying, which allows them to make informed decisions. In 2018, the European Union ("EU") introduced the Packaged Retail and Insurance-based Investment Products ("PRIIPs") regulation, which required investment managers to provide retail investors with a Key Information Document ("KID"), explaining a product's features, risks and all associated costs, including their ongoing charges figures ("OCFs"). This regime runs parallel to the 2009 Undertakings for the Collective Investment in Transferable Securities ("UCITS") regulation, which applies to the EU and any UK funds that market themselves to EU investors.

Following Brexit, the UK began work on updating its own PRIIPs regime, with the UK FCA reviewing and adjusting the framework to make it more relevant to the UK market. As part of this, the UK FCA implemented new cost disclosure guidance on 1 July 2022, which required closed-ended investment companies to report in the same way as open-ended funds.

These regulations aimed to increase transparency for non-UCITS vehicles by requiring them to disclose their costs more clearly. However, as investment companies already provided detailed cost information under the former rules, institutional investors and intermediaries were made to report these costs again in their own disclosures to clients, which has resulted in double counting. As a result of the double counting, some investors have been unable to invest in investment companies or have significantly reduced their exposure.

It is broadly accepted by the industry and by the Government, that this single aggregated figure is not an accurate representation of the actual costs of investment in shares in an investment company. Following the successful campaigning of a group of parliamentarians and industry participants, HM Treasury proposed a Statutory Instrument to remove the requirement for investment companies, along with persons advising on or selling shares of investment companies, to produce a KID. Additionally, investment companies, and firms investing in them will not be required to disclose costs and charges relating to investment companies to clients, pursuant to the MiFID Org Regulation.

The Statutory Instrument became law on 22 November 2024. However, additional issues have been encountered post period end, with investment platforms continuing to require ongoing charges to be disclosed in the KID. We continue to monitor the impact of cost disclosure on the Company, and the Investment Adviser has been active in the campaign to resolve the issue.

1. APM – for definition and calculation methodology, refer to the APMs section on pages 170 to 172.

Investment Adviser's report

Company position

The Company's portfolio remains well diversified across a wide range of operational renewable energy projects, social infrastructure (through PPP/PFI schemes) and supported living projects. The Company's explicit diversification objective has historically enabled it to adapt to developments in any one sector (such as decreasing yields and more competition) and move into other areas if a sector no longer represents attractive risk-adjusted returns.

In the 14 years since its IPO, the Company has seen this cycle play out across multiple sectors and has adapted its approach to investing as one sector matures or sought out new sectors for investment. Similarly, where there have been changes to investor sentiment around certain sectors (such as supported living) or an end to a subsidy regime (such as in PPP/PFI), the Company has been able to maintain its investment policy, objective and strategy which have been consistent since IPO.

Key investment activity

The Investment Adviser's focus for the year has been executing the Company's capital allocation policy. The first disposal contributing to the stated aims was completed in April 2024. Post year end, one additional disposal was completed, with another disposal expected to complete subject to contract. As previously noted, there are three stated aims of the policy: reducing leverage, returning capital to shareholders, and adjusting exposure to supported living and merchant electricity prices within the portfolio.

The Company has made material progress in reducing leverage, with total commitments reduced from £190 million to £150 million in March 2024, and drawn balances reduced to £57 million at year end, down from £104 million at 30 September 2023. This represents a net debt position of £45.2 million at 30 September 2024 and an LTV of 6.2%.

Furthermore, the Company completed buybacks of 3.4 million shares for a consideration of £2.2 million.

Post year end, the rooftop solar assets disposal and the expected disposal of onshore wind assets will reduce loans with exposure to merchant electricity prices by c.£27 million. The Investment Adviser is progressing transactions which will materially reduce the Company's exposure to the supported living sector in 2025.

New investments have not been a priority for the Company due to its focus on its capital allocation policy. However, the Company has completed a handful of follow-on investments to optimise the performance of existing portfolio investments and made one new investment to support an existing borrower. A full summary of investments and repayments for the year is shown on page 47.

Portfolio exposures

Low / Medium / High — Impact / Likelihood

	Renewables								SH	PPP/PFI			
	Wind (onshore)	Solar	Biomass	AD	Hydro	Geothermal	Gas peaking	Electric vehicles	Supported Living	Healthcare	Leisure	Education	Waste
Asset characteristics: Market risk													
Asset characteristics: Credit risks													
Asset characteristics: Operational risks													
Asset characteristics: Legal/regulatory													
Overall score													
Sector exposure (by value at 30 September 2024)	13%	25%	10%	9%	2%	<1%	1%	1%	12%	26%			
Periodic change (12 months)[1]	Reduction in volatility of electricity prices benefiting all renewable sectors								Easing of inflation has reduced pressure on Registered Providers ("RPs") associated with rental growth	Government with a significant majority promotes political stability			

1. For further commentary refer to page 36.

Investment Adviser's report continued

Investment risk

The table below details the Investment Adviser's view of the changes to the risk ratings for sectors where changes have been observed in the past year.

Risk	Sector	Change in year	Description
Market risk The risk of an investment being exposed to changes in market prices, such as electricity prices or inflation.	Renewables (all sectors)	Decreased	Electricity prices have continued to soften over the course of 2024, with reduced levels of volatility across the sector. However, geopolitical tensions in the Middle East continue to pose a risk. The Company is exposed to electricity prices and inflation as part of its renewable energy portfolio, and the higher price environment has been beneficial to its assets. In the year, inflation has eased to a level where this is no longer an issue for borrowers, causing the risk to decrease.
	Supported living	Decreased	Inflationary increases in the interest rates on Company's loans weren't matched on a pass-through basis with increases in local authority rent payments during periods of abnormal inflation, which place the Company's borrowers under pressure.
Credit risk The risk of reliance on customers and suppliers to provide goods and/or services for a project and manage certain project risks as part of such arrangements.	Supported living	Decreased	The leases on the underlying properties have inflation linkage and, as such, the amounts charged to RPs have increased during the year. The underlying RPs have agreed to pass the increases on to local authorities. As inflation has eased, this pressure has decreased. We have also seen material progress by the RPs to improve their governance protocols to comply with the RSH's standards.
Operational risk The risk of exposure to the construction and/or operations of a project associated with the failure of people, processes and/or systems required to monetise an asset.	Renewables (all sectors)	Decreased	Operations have improved across the portfolio, with changes in the management and operational teams at certain biomass and bio-power plants having positive impacts on performance.
Legal/regulatory risk The risk associated with changes to laws and/or regulations. This covers UK-wide, non-specific risks, such as changes to the tax regime, and specific risks such as changes to a subsidy regime that a project relies on.	Renewables (all sectors)	Decreased	The UK finds itself in a very different position to this time last year, with a new Government and considerably more certainty around policy support for renewable energy. The clean energy transition is second only to economic growth in the new Government's mandate, early policy developments, and further detailed announcements as part of the Autumn Budget, suggest a supportive policy environment. Significant changes to the UK tax regime are unlikely to impact the Company's portfolio of loans.

Interest capitalised

The Company received total loan interest income of £87.3 million (30 September 2023: £80.8 million) from the underlying investment portfolio. Of this, £65.1 million was received in cash and £22.2 million was capitalised in the year (30 September 2023: £58.8 million and £22.0 million respectively). Refer to note 3 for further information. The capitalisation of interest occurs for three reasons:

1. Where interest has been paid to the Company late (often as a result of moving cash through the Company and borrower corporate structures), a capitalisation automatically occurs from an accounting point of view.
2. On a scheduled basis, where a loan has been designed to contain an element of capitalisation of interest due to the nature of the underlying cash flows. Examples include projects in construction that are not generating operational cash flows, or subordinated loans where the bulk of subordinated cash flows are towards the end of the assumed life of a project, after the repayment of senior loans. Planning future capital investment commitments in this way is an effective method of reinvesting repayments received from the portfolio back into other portfolio projects.
3. Where loans are not performing in line with financial models, resulting in:
   (i) lock-up of cash flows to investors who are junior to senior lenders; and
   (ii) cash generation is not sufficient to service debt.

Other unscheduled capitalisations in the year related to the re-direction of cash flows into three gas-to-grid anaerobic digestion projects in Scotland to address performance issues encountered in the year.

The table below shows a breakdown of interest capitalised during the year and amounts paid as part of final repayment or disposal proceeds:

	30 September 2024 £'000	**30 September 2024 £'000**	30 September 2023 £'000	30 September 2023 £'000
Loan interest received		**65,129**		58,791
Capitalised (planned)	**14,868**		18,253	
Capitalised (unscheduled)	**7,300**		3,706	
Loan interest capitalised	**22,168**		21,959	
Capitalised amounts subsequently settled as a repayment	**(9,297)**	**9,297**	(10,822)	10,822
Adjusted loan interest capitalised[1]	**12,871**		11,137	
Adjusted loan interest received[1]		**74,426**		69,613

The table below illustrates the forecast component of interest capitalised that is planned and unscheduled.

	30 September					
% of total interest	2024	2025	2026	2027	2028	2029
Capitalised (planned)	19%	9%	9%	10%	14%	10%
Capitalised (unscheduled)	9%	1%	—	—	—	—

The Investment Adviser and the independent Valuation Agent review any capitalisation of interest and associated increases to borrowings to confirm that such an increase in debt, and the associated cost of interest, can ultimately be serviced over the life of the asset. To the extent an increase in loan balance is not serviceable, a downward revaluation is recognised, notwithstanding that such an amount remains due and payable by the underlying borrower and where capitalisation has not been scheduled, it attracts default interest payable.

1. APM – for definition and calculation methodology, refer to the APMs section on pages 170 to 172.