Gresham House
Specialist asset management

Overall Portfolio and Operational Review to 30 September 2017

We are pleased to report that the portfolio of assets owned by Hazel Renewable Energy VCT 1 Plc and VCT 2 Plc extended its multi-year period of solid performance in the year ending 30 September 2017. This was achieved in spite of a significant headwind in the form of adverse weather conditions faced by all owners of solar generation assets in the UK. The focus in the year was to generate as much yield as possible from the portfolio, and to reduce risk to revenues over multiple years by building in resilience through a new spare parts strategy and negotiating better insurance terms.

Overall, the Company owns a well-diversified portfolio of assets of high build quality. The ground-mounted sites and the solar installations located on the roofs of residential properties owned by housing associations across the UK have performed well over the years and account for circa ninety percent of the cashflows and therefore the value. The small wind turbine portfolio and to a lesser extent the small portfolio solar installations located on the roofs of privately-owned houses and schools have performed less well over the years, although the latter has done better than expected in the past year.

Starting with macro factors, inflation, a parameter that the portfolio is very sensitive to (as a result of inflation-linked power subsidies) steadily increased through the year. RPI (Retail Price Inflation) increased from 2.0% to 3.9% over the year. The substantially higher level is yet to be reflected in the tariffs as adjustments become effective in April, however this increase is a very positive development for the portfolio since each 1% increase in valuation, adds circa £100,000 to portfolio revenues.

Climactic conditions however were unfavourable. The amount of solar irradiation falling on the solar panels showed a marked decline from prior years. For the six ground-mounted solar power plants remunerated by Feed-in-Tariffs (FiTs) that account for around 70% of the value of the portfolio, irradiation fell 5.5% short of forecasts. For the two ground-mounted sites remunerated by Renewable Obligation Certificates (ROCs), irradiation came in line with forecasts due to one of the parks being located on the East Anglia coast which typically experiences different weather patterns than Central and Western England where the other parks are located. It is extremely difficult to forecast irradiation on a year- by-year basis. Conditions have been poor in the last two years and we hope that a reversion-to-mean effect manifests itself in the next year. Power prices drifted down moderately throughout the year, however the portfolio's very low exposure to power prices (less than 5% of revenues are currently from variable tariffs) means that this has a very modest impact.

We are pleased to report that the performance of the ground-mounted asset base that accounts for 79% of the portfolio value was in line with expectations despite the fact that we raised these expectations during the year. The rooftop solar asset portfolio that accounts for circa 12% of the overall valuation performed slightly ahead of expectations. Generation was 1% better than forecast. An area of the portfolio that experienced a significant underperformance is the small wind portfolio. This portfolio accounts for around 10% of the overall value of the portfolio. We were hopeful that the small uplift we experienced in performance in the prior year would continue, however the opposite has happened. Around a third of the portfolio consists of Chinese- made Huaying HY5 wind turbines, some of which experienced significant technical and safety issues during the high wind conditions that prevailed in February. Britwind, the O&M Contractor, communicated that they would be unable to maintain these assets in the future due to the poor technical quality of the turbines and lack of support from the manufacturer, which invalidated our insurance coverage. This combined with the safety/public liability implications forced us to put the turbines on mechanical break.

The third factor that determines performance is costs. Most of our work to reduce controllable costs was done in the prior year where we renegotiated our O&M and insurance contracts and achieved cost reductions of more than 50%. We also achieved savings in bookkeeping and accounting costs.

This year however, we suffered the impact of a significant increase in business rates. The Government decided to increase business rates by close to three times for ground-mounted solar farms that were built in the 2010 to 2012 period and therefore earned very high FiTs. The impact on the portfolio is an increase of £175,000 per year in the cost base once the taper period of three years to moderate the impact is over. There is the potential of further reductions in O&M costs as prices in the UK become more aligned with those in Continental Europe, however the long-term nature of our O&M contracts (a requirement under the debt facility agreements) mean that we will not enjoy the benefits of such a realignment for several years to come. We are now working on achieving cost reductions in ancillary areas such as electricity imports, communications, security and monitoring, however we do not expect these savings to amount to more than £10,000 per annum across the portfolios.