

Third Quarter 2021

Quote of the Quarter

“As many have warned in the past, freedom is unlikely to be lost all at once and openly. It is far more likely to be eroded away, bit by bit, amid glittering promises and expressions of noble ideas.”

— Thomas Sowell

A Quickening Pace

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Introduction

The kids are back in school, the air is getting crisp here in Minnesota and the investment team is full steam ahead on a wide variety of sustainable infrastructure and impact secondaries investments.

We had a very active third quarter in terms of new investment activity, capital inflows, an important addition to the team, copious media interaction and an award or two. Among the highlights were (1) being awarded both federal and state tax credits that will support an investment initiative focused on low income areas across America, (2) being named to the PEI / New Private Markets' Impact 20 list (recognizing the world's largest private markets impact managers), (3) winning the Environmental Finance 2021 Impact Award for our work on Project Golden Bear (a waste to renewable natural gas project in San Bernardino County, CA) and (4) having Lucy Fan rejoin our infrastructure investment team after a nearly three year term as the Director of Commercial Operations at Peak Power Energy (an energy storage and demand response technology provider). Lucy's knowledge of energy storage, grid optimization and renewable energy generation is the perfect addition to the team given the burgeoning opportunities to build new energy storage systems as well as retrofit existing wind and solar farms with energy storage systems across this great country of ours.

The marketplace is booming and there is a lot to touch upon, so let's dive in.

Market Update

Sustainable Infrastructure

Federal infrastructure bill. We have been talking about the potential for a new infrastructure bill in each of the last two quarterly market commentaries, and as of this writing (Sept. 29), the House of Representatives is scheduled to vote on the Infrastructure Investment and Jobs Act tomorrow. The Senate has already passed the bill. Key provisions relevant to our sector include:

- \$65 billion for electric transmission upgrades and grid reliability
- \$15 billion for electric vehicle infrastructure
- \$55 billion for water utility repair
- \$50 billion for resiliency projects
- \$21 billion for environmental remediation of polluted sites

Such funds would almost certainly spur local and regional agencies and developers to initiate new infrastructure projects similar to those North Sky has participated in previously. Additionally, the larger \$3.5 trillion tax and spend bill is still in flux. The bill currently includes the following interesting points—ones we are watching closely:

- A 10-year extension of the 30% Investment Tax Credit (“ITC”) for solar projects
- Additional extensions of tax benefits for biogas and alternative fuels
- A 10-year extension of the \$25/MWh Production Tax Credit (“PTC”) for wind projects, and a newly created clean hydrogen PTC
- A separate ITC for energy storage that would make both retrofit and new battery storage projects more attractive
- Requirements for “made in the USA” equipment and materials
- The return of a cash payment option for tax credits (reducing the need for tax equity)

All of these would make an already attractive sustainable infrastructure marketplace even more attractive to investors like North Sky. These proposals would accelerate new construction of solar, wind, energy storage, hydrogen and potentially even nuclear power systems. The proposals also would make retrofits or repowering of older systems more economical today, such that repowering timetables might be pulled forward from the future into the next 2-3 years. Many developers are grappling with inflation across the board. Costs have gone up for solar panels, inverters, racking, wind turbines, towers, shipping charges and labor costs. These proposals would provide relief from those cost pressures. Additionally, these incentives may give an unexpected boost to certain investments that are already in our portfolio, increasing our expected return on them.

We will stop there, as the legislative “sausage making” is ongoing, and complicated further by coinciding with hitting the federal debt ceiling. We hope that a sensible overall plan can be negotiated and sent to the White House soon.

Spotlight on municipal wastewater methane. We believe there is an opportunity to put a large amount of capital to work in wastewater methane projects and earn a very attractive return today. There are more than 16,000 publicly-owned wastewater treatment plants in the United States that process more than 34 billion gallons of wastewater each day.¹ In 2017, this daily activity produced an estimated 13.8 million tons of waste sludge, the decomposition of which released 568

kilotons of methane (CH₄), equivalent to releasing 14.2 million tons of CO₂ into the atmosphere each year.²

Data for 2019 suggests the magnitude of annual wastewater methane emissions had grown to 18.4 million tons of CO₂ equivalent.³ At present, about 1,269 wastewater treatment plants (8% of the total) in the US have anaerobic digestion facilities for processing sludge, but only 860 (5%) put the harvested biogas to a beneficial use, typically using it onsite in combined heat and power systems.⁴ One recent estimate suggested that wastewater methane has the potential to meet 12% of US electricity demand.⁵

Our approach to wastewater methane projects is to partner with qualified developers and operators to construct methane upgrading facilities at existing wastewater treatment plants that have digestion tanks, or to add digesters and methane processing facilities to those that do not. That is exactly what we did in our Point Loma and Project Golden Bear investments. At Point Loma, the gas was used to produce electricity via a large array of fuel cells at the University of California San Diego and a nearby town. Project Golden Bear will utilize the captured methane to produce 320,000 mmbtu per annum of Renewable Natural Gas (“RNG”) and inject that into the local natural gas pipeline, displacing an equivalent amount of conventionally extracted gas from the pipeline system.

We are smartly positioned in this subsector given our investment experience, deal sourcing network and relationships with key players, including utilities, pension plans, endowments and others who ultimately want to buy these strong, consistent cash flowing assets. There is also important legislative and policy support for digester gas projects, such as the Federal Renewable Fuel Standard or California Low Carbon Fuel Standard.⁶

Impact factoid: Project Golden Bear will prevent the release into the atmosphere of 6,000 metric tons of methane per annum, which is equivalent to preventing the release of 150,000 metric tons of CO₂, removing 33,000 vehicles from the road, or planting 2.5 million trees.⁷

Natural gas prices bode well for renewables. Natural gas prices have been rising steadily since early April and quite rapidly since mid-August. On September 28, the Natural Gas Futures (Nov 2021) price closed at \$5.88 per mmbtu, the highest closing level in more than seven years. Prices have been climbing lately due in part to reduced natural gas production in the Gulf of Mexico resulting from Category 4 Hurricane Ida which hit Louisiana on August 29. Zacks recently reported that 75% of Gulf natural gas production was still offline.

High natural gas prices make wind and solar relatively more competitive with natural gas fueled power plants, particularly for large utilities that are procuring renewable power alongside natural gas fueled power plants. As investors in wind and solar, North Sky funds benefit from these further shifts from gas to renewables. Additionally, as developers of renewable natural gas (“RNG”) projects, North Sky funds benefit from capturing waste methane from landfills and wastewater treatment plants and upgrading it into RNG, which then sells for a premium above the price for fossil fuel derived natural gas.

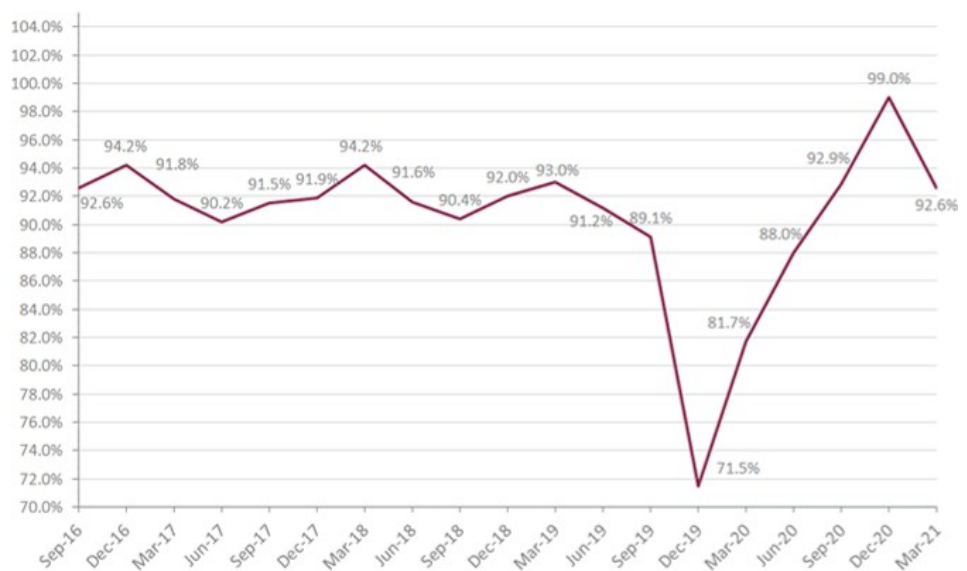
Natural Gas Price (\$ per million British thermal units)



Impact Secondaries

Market conditions are setting up for a busy Q4. Our deal pace has been steadily increasing all year and we expect that will continue through yearend. Generally, the secondary market has been on a tear following about a two-quarter lull due to covid early last year. Activity rebounded surprisingly sharply, in large part due to some of the mega funds trying to make up for the standstill. Some of those buyers have been so desperate to deploy capital that they bid prices up to record levels recently, such that the average secondary pricing for deals that were based on 12-31-20 Net Asset Value were done at only a 1% discount. See chart below.

PEFOX Average Secondary Pricing



The frenzy seems to have abated, and pricing returned to normal levels for deals that were based on 3-31-21 NAV. At a 7.4% average discount, recent pricing was consistent with discounts seen over most of the prior five years. The buyers who

wanted to invest heavily have largely done so, and the market is back in balance for the moment. The recent increase in pricing shown in the chart was not solely due to a rush to deploy capital. For many funds, valuation increases were on the horizon due to pending SPAC mergers, completed IPOs or expectation that conservative GPs would soon have to incorporate the frothy public and private comparable multiples into their valuation methodology.

Finally, we believe the next few quarters will offer more opportunities for LP secondaries (transferring LP interests from one investor to another). We believe this based on several factors. There has been a material rebound in private market valuations since the pandemic lows of Q2 2020. At those lows, most LPs held onto their stakes, hoping for an uplift in the coming quarters. That uplift came steadily from Q3 2020 to Q2 2021, at which point LPs perceived valuations had recovered, secondary pricing seemed fair and the LPs once again became willing sellers. On a related note, public equity valuations started to flatten out in Q3 2021, rather than going straight up as they had been doing. Major pricing trends in public equities usually show up in private equity valuations a quarter or two later. Savvy sellers factor this into their decision-making process. In this case, potential sellers may interpret a flattening stock market to indicate that private valuations have peaked for the moment and now may be a reasonable time to sell their LP interests rather than hold until the next leg up in the stock market.

The recent lack of attractive discounts in LP secondaries has propelled an increase in the number of GP-led secondaries, which now account for approximately 50% of total secondary volume. Typically, GP-led secondaries are where one or more highly-promising assets in a mature portfolio are transferred to a special purpose vehicle and given more time and follow-on capital to wring additional value out of the assets—often significantly more value. While GP-led secondaries are typically underwritten with higher cash-on-cash return expectations, they are priced with little, if any, discount at close. Campbell Lutyens confirmed this recently, reporting that 98% of GP-led secondaries priced at a discount of 10% or less in 1H21. The discount, or embedded value at close, is what enables the attractive reverse J-curve effect of secondaries. Understanding these trends and investing proactively is important in today's secondary market.

In our impact secondary niche, we are also seeing many GP-led opportunities, but with smaller transactions sizes, less competition and bigger discounts to NAV. In many of the GP-led transactions that we've completed for our current impact secondary fund, Clean Growth V ("CG V"), the investments were initiated not by a GP's motivation to "take a second bite of the apple" but rather by traditional seller dynamics such as strategy shifts, management changes, generational transitions, liquidity crunches and holding period mismatches within investor syndicates.

Consistent with our experience since 2013, broader market trends inform our investment analysis but often do not directly map over to the impact marketplace. The impact market and the general market are still distinct pools, which is a good thing. **Since inception in late 2018, CG V has achieved an average 33% discount to NAV across its portfolio of LP secondary transactions and an average 45% discount to NAV across its GP-led transactions, which both compare favorably versus the general market pricing described above.**

North Sky News



We are pleased to announce that [Ying Lucy Fan](#) has joined the firm as Vice President.

Lucy joins North Sky from Peak Power, an Ontario-based battery storage developer where she has served as Director Commercial Operations and Transactions since 2018. Previously, she was a Senior Associate at New Energy Capital, where she worked for more than four years with Adam Bernstein, who is now North Sky's head of sustainable infrastructure. While at NEC, Lucy and Adam acted as sub-advisors to North Sky's 2010 and 2015 vintage infrastructure funds.

Read the full press release [here](#).

privateequitywire

Private Equity Wire asked North Sky's [Adam Bernstein](#), for his perspective on the most recent \$1.2T bipartisan US infrastructure bill.

Read Adam's insight on what state and federal support for comprehensive zero-emission targets would mean for the PE infrastructure [here](#).

New Private Markets

[Scott Barrington](#) was featured in New Private Markets' Impact 20 video profile series. Scott discussed North Sky's more than two decades of growth and impact investing experience, the firm's unique strategies and their investments' lasting positive impact. "It is very rewarding because everything we do is making the world a better place to live in," he said.

View the full press release [here](#).



North Sky Capital has been named a winner in the Environmental Finance 2021 IMPACT Awards in the Impact Investment / Project of the Year – Renewable Energy category.

North Sky was recognized for its investment in "Project Golden Bear", a new wastewater methane-to-renewable natural gas ("RNG") facility located in Victorville, California.

Read the full press release [here](#)

North Sky Capital has been awarded \$45 million in tax credits as part of the New Markets Tax Credit Extension Act of 2021. Granted by the Treasury Department's Community Development Financial Institutions ("CDFI") Fund, the

tax credits are designed to spur investment in low-income communities throughout the country, a goal that North Sky has embraced in recent years.

Read the full press release [here](#).

North Sky Capital has been awarded \$3.7 million in tax credits for investments in Kentucky as part of the state's New Markets Development Tax Credit Program.

Read the full press release [here](#).

Pensions&Investments

Scott Barrington spoke to Pensions & Investments on the increasing investor interest in renewable energy and accompanying sustainable infrastructure projects. North Sky has numerous investment projects like these, including generating renewable natural gas, turning manure and poultry litter into energy and fertilizer and water purification.

View the full press release [here](#).

The New York Times

[Adam Bernstein](#) spoke with the New York Times regarding what it would take to reach President Biden's recent pledge to cut global methane emissions by a third in the coming decade.

Read the full article [here](#).

New Private Markets

New Private Markets reporter Toby Mitchenall asked Scott Barrington to share his perspective as an impact investing veteran regarding the entry of large multi-strategy asset managers in the industry.

View the full press release [here](#).

Upcoming Events

We are regular speakers and attendees at key industry events. We hope to see you at these upcoming events:

- | | |
|----------------------|--|
| October 14-15, 2021 | Tennessee Bankers Association Trust and Wealth Management Conference , Nashville |
| October 18-21, 2021 | Infrastructure Investor Global Summit Berlin 2021 , Berlin & Virtually |
| October 18-22, 2021 | SOCAP21 Virtual , Virtual |
| November 16-17, 2021 | Infrastructure Investor New York Forum , November 16-17, New York |

Let's Keep Talking

We are eager to hear from you. Please contact us if you have:

- an interest in impact investing and would like to learn more about how we can help you take the [first step](#),
- A desire to learn more about our [sustainable infrastructure investment strategy](#)
- an existing impact investment that you would like to [sell](#), or
- a sustainable infrastructure project in need of [financing](#).

For more information, please see our [North Sky Capital Firm Brochure](#).



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- 1 <https://infrastructurereportcard.org/cat-item/wastewater/> , <https://www.epa.gov/nutrientpollution/sources-and-solutions-wastewater>
- 2 http://css.umich.edu/sites/default/files/Wastewater%20Treatment_CSS04-14_e2020.pdf , <https://www.epa.gov/sites/production/files/2019-04/documents/us-ghg-inventory-2019-chapter-7-waste.pdf>
- 3 <https://www.epa.gov/sites/production/files/2021-04/documents/fastfacts-1990-2019.pdf.pdf>
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- 5 https://www.wef.org/globalassets/assets-wef/direct-download-library/public/03---resources/waterresourcesutilityofthefuture_blueprintforaction_final.pdf
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