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panorama

Part four of an on-going series

Potential investors in renewables are everywhere, but debt finance is hard nut to crack

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Dan McCue

Why should energy-intensive corporations invest in green power plays like wind and solar farms?
According to Fintan Whelan, corporate finance director and co-founder of Mainstream Renewable Power, because they're uniquely situated to benefit from the many potential ripple effects of such an investment.

"It's useful to contrast their situation with that of a pension fund or a Japanese trading house, the usual suspects that are identified as deep pools of capital that will invest in something like an offshore wind farm," he said during an extended conversation with Renewable Energy Magazine.

"They can only benefit to the extent of the cash flows coming off the project," he said. "Now, that can be substantial, but it's a pure play. Returns being equal, it doesn't matter whether the investment is in a green energy project or not. It could be in an apartment complex, for instance.

"Now, a corporate can realize the same benefits, but it can also get a lot more," Whelan continued. "For instance, a green energy investment can provide them with hedging qualities on the cost of their electricity."

He went on to explain that corporations typically consume what he called "pure, brand name power" or, in the alternative, market-rated power "with a little bit of green power mixed with it." But those who invest in wind and other renewables often qualify for government incentives intended to encourage just such investment.

"So what you have is a situation where they should be getting a better price for the electricity they sell compared to the electricity they are paying for," Whelan said.

But wait, there's more, as American pitch men like to say.

Corporations that invest in offshore wind farms and other major renewables projects have a compelling case to make to the consumers of their products who are sensitive to climate change and fossil fuel related concerns.

"The corporate can say, 'Well look, I am an energy intensive user, but I've gone and caused a wind farm to be built in the North Sea that generates about half the electricity I use, so I am making a contribution to off-setting the environmental effects of my energy consumption,'" Whelan said. "In effect it's a way to say, 'I'm a good guy, and the reduced carbon footprint of my business is reflected in the goods and services that I supply to you."

Whelan also argued renewables will be as stable in price over time as nuclear power has proven to be, and therefore, that by embracing offshore wind and the like, corporations can "future-proof a chunk of their exposure when it comes to electricity and carbon emissions."

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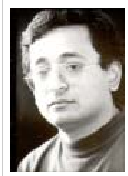

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"That's a pretty compelling statement to make to your investors... to be able to say, 'We've stabilized our earnings to this extent, and this reduced volatility in our earnings should have a favorable impact on our share price,'" Whelan said.

"While you're at it you might mention that you're not aware of any of your competitors doing this, and suggest that they may want to hammer the competitors' share price," he laughed.

"What all these ripple effects do is introduce an iron connection between the cash flows from the investment and the consumption of electricity," he added.

The utility space is changing

From corporations and wind farms, we were soon on to the utilities in the middle.

"I define a utility as a perfectly evolved organism for connecting customers' bills to investor cash flows," he said.

"A utility has electricity generation and it has customers and it lives in the intermediate space," he continued. "In other words, a utility can contract for electricity generation knowing that it has customers that it can sell it to, and normally, they want to keep those two things in balance. At least broadly."

According to Whelan, the bitter challenge for utilities in Europe at the moment is they are faced with a wall of capital expenditures (Capex) and just don't have the money to do all that needs to be done, including replacing aging or less efficient power plants, making government mandated investments in renewables, and doing something about what is increasingly seen as an inefficient transmission system.

"Now, you might say, 'All of these things are needed and necessary and arguably good; why won't their investors give them the money?'" Whelan said. "Well, because if they allowed the utilities they invest in to do all this Capex, then they can say good bye to dividends for the next 15 years.

"Plus it changes the risk profile of the utility," he said. "For instance, with the exception of DONG Energy, the Danish firm, there are no utilities that are well-experienced in building mega-renewable energy projects in the middle of the North Sea. None of them," he said.

The result of all this is that developers of major renewables projects are increasingly looking to infrastructure funds to help get things done.

"Look at it from the institutional investors' perspective," Whelan said. "If they invest in a utility so that it can go off and build a wind farm, all they can expect is a utility return -- and they might be lucky to get that, if the risk profile changes.

"On the other hand, they might say, 'If I invest through an infrastructure fund, I can get the right reward for the activity undertaken, which is riskier and therefore, I should get a better reward for it.' That's the logic of shifting to other type of vehicles, such as infrastructure funds."

"But there's another consideration to bear in mind at this point: infrastructure funds provide equity; they don't provide debt. Now, you might be tempted to say, 'Right, project finance banks will provide the debt,' but there's only a finite amount of debt around and a lot of it has dried up," he said. "And it's not just because of the current uncertainty in the economy, it's just that the scale of the need for project finance has way outstripped the capacity."

An option in bonds?

Further complicating the funding picture for large-scale renewables projects is Basel III, the global regulatory standard on bank capital adequacy, stress testing and market liquidity risk agreed upon by the members of the Basel Committee on Banking Supervision in 2010-11.

In lay terms what it says is, the longer the term of the loan, the more capital the bank has to set aside to back it up.

"What that does is make money very expensive, and what it means is that a project finance bank is no longer the right institution to lend long," Whelan said.

As a result, project developers are exploring various bond type vehicles.

"Among the kinds of things you hear about are debt funds, which are kind of an alternative to a traditional bond," Whelan said. "With this kind of funding, the thinking goes, investors who want to see your debt/risk profile and infrastructure assets would now have a convenient vehicle for doing so, and they don't have to get involved in construction or get their hands dirty at all."

"Now, that's the idea," Whelan continued, "but it's proving to be very intractable. I attend a lot of conference and this idea comes up again and again and again, and very unusually for finance, it's been really slow to get going."

"I'm not quite sure what's holding it back, but it's taking its time in coming out," he said.

"One of the stories right now in Europe is that there's an appetite for these kinds of projects among the infrastructure funds, and there's an appetite among some of the bigger pension and sovereign wealth funds to invest -- or co-invest with infrastructure funds, which is an interesting development -- but the debt side is difficult. So instead of shifting the capital intensity that way, my proposition is utilities could shift it to their best customers: The energy-intensive corporates." Whelan said.

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