Roundtable

PHOTOGRAPHY: MICHA THEINER

From left: Jeroen Wolfs, Dan Wells, Kai Rintala, Shreya Malik

Living in a merchant-power world

As renewables projects ditch subsidies, four industry participants tell Zak Bentley why they prefer market risk. But all acknowledge they will need to work harder than ever, not least to convince investors they are well-equipped to handle the sector's changing risk profile

The day before we gather at Foresight Group's offices in London's Shard tower for our energy transition roundtable, the UK government announces its 'Offshore Wind Sector Deal'. Under the initiative, a third of the country's electricity is to be powered by offshore wind by 2030.

The announcement is significant, especially considering that 623 days earlier a different UK government of the same political persuasion had issued an ultimatum to the sector, insisting that "offshore wind is still too expensive" and that it "needs to move quickly to cost-competitiveness".

The contrast is emblematic of the growth in renewables, not just in the UK but across the world. Yet our roundtable also takes place shortly after the offshore wind debacle in Taiwan, where the messages sent out by the Taiwanese government to some of the world's largest renewable investors were, to put it euphemistically, rather mixed.

It was a reminder of some of the political and regulatory risks that used to be posed by renewable energy subsidies. These are risks that the participants at our roundtable – Foresight Group's Dan Wells, Shreya Malik of Partners Group, Taaleri Energia's

Kai Rintala and Jeroen Wolfs from Aquila Capital – have largely left behind as they increasingly operate in a subsidy-free era of merchant power. Against this backdrop, the first key question for them is as follows: are we living in a riskier or a safer world when it comes to investing in renewables?

"We can't just acquire homogeneous assets that have simple feed-in tariff structures anymore," says Wells. "We have to be active and get involved in putting together corporate power-purchase agreements, for example, to underpin the projects in question. From a portfolio standpoint, in some ways, it can be quite helpful in that we can just price assets based on the underlying credit of the corporate offtaker, as opposed to having to make calls on various kinds of regulatory or sovereign risks. Certainly, the supply of corporate PPAs is a key limiting factor."

Wolfs also believes much of the industry is now at a less risky standpoint.

"Moving from subsidised to unsubsidised means swapping regulatory risk for market risk, with those assets basically being able to survive on their own," he says. "So you could argue these assets are actually less risky. There's a lot of education involved [for certain investors], but it does deliver opportunities for asset managers like ourselves."

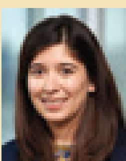
AROUND THE TABLE

Jeroen Wolfs, co-head, Energy Transition Infrastructure Fund, Aquila Capital

Wolfs joined Aquila's Amsterdam office last September after nearly nine years at Dutch pension fund PGGM. He previously spent four years as an analyst at advisory firm Grontmij Capital Consultants, later acquired by consultancy and engineering group Sweco.

Dan Wells, partner, Foresight Group

Wells joined Foresight in 2012 and is based in its London office, where he is responsible for the firm's existing retail solar funds as well as deploying its energy infrastructure strategy more widely. Wells, who has 18 years of experience under his belt, was a managing director in Sindicatum's corporate finance division.



Shreya Malik, vice-president, private infrastructure Europe, Partners Group

Malik, who is based in London, has been with Partners Group since 2011 and has 11 years of experience. She previously worked at Oxera Consulting and had assignments at Oxford University, Standard Chartered and Principal Group.

Kai Rintala, managing director, Taaleri Energia

Rintala joined the Helsinki-listed energy infrastructure developer in 2016 after nearly 11 years with KPMG. He has worked with the firm both in Helsinki and in London, advising public and private sector clients on strategy and transactions across energy, transport and social infrastructure.

PROTECTIVE MEASURES

Rintala agrees with Wolfs and adds that, coming from a liquid Finnish market, there are several ways in which managers can protect themselves.

"We are effectively swapping regulatory risk for counterparty risk, which we believe is a positive development in many markets," he says. "In order to protect our investors and stay true to our infrastructure heritage, we need to ensure that the majority of our revenues are properly contracted. And to do that, we need to consider and understand the creditworthiness and associated risks of the offtaker, PPA provider or financial hedge that we put in place as we structure our investments."

Europe has struggled to keep pace with the progress made by North America on corporate PPAs. However, Malik says work is taking place to bring a more standardised formula to the market and thereby ensure that projects are less risky.

"We see a bigger role for the banks, the supply chain providers and governments on a structure that would work," she says. "More and more PPAs will substitute the classic subsidy-based feed-in tariffs.

"Nevertheless, the question is: how deep will the PPA market be? We see the link between bank financing and PPAs or feed-in tariffs softening further, and investors that can assess merchant risk are expected to gain market share. The market is adapting quite quickly and we could see an evolution in available structures that would offer a different risk-return proposition. This can already be seen in several parts of Europe. It's probably on a smaller scale [than in North America], but it's something that's coming into force."

The flipside of finding strategies to adapt to the subsidy-free, merchant-power world is whether this is what investors even imagine renewables to be when they commit the capital. A survey released in February from Octopus Group showed a significant majority of investors still wanted wind and solar sites to benefit from government support, amid concerns about energy prices. The survey's respondents also demonstrated a preference for UK-based assets. Are their expectations where the market is at?

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> The energy transition is twofold. On the supply side, renewable energy is substituting fossil fuel, while on the demand side, there is a need to be more efficient and more flexible" **Malik**

adapt to the new reality of an uncertain, unsubsidised world in combination with very cost-competitive proven technologies," says Wolfs. "It's not necessarily a mismatch in expectations, but I think it's a continuous education for the investor community about the way these projects work nowadays. It's just a different kind of risk-return profile."

The situation does, however, require more work from the managers.

"What investors want from us isn't to take more risk as managers, but to seek out good risk-adjusted return," says Wells. "You have to think of the whole energy and infrastructure system together, which is increasingly interdependent. You can't just invest in solar if you don't understand what's happening in electric vehicles, for example. These are the kinds of things we have long investment committee discussions about."

Meeting investors' return expectations also relies on making the most of asset management.

"I don't think we see ourselves taking more risks than we used to," says Malik. 'We are pursuing a building core strategy in the renewables space and aim to work together with key stakeholders including suppliers, offtakers and lenders on new project structures as we adapt to a rapidly evolving market."

TERRA INCOGNITA?

Alternatively, the solution may lie in heading to pastures new, despite investors' preferences for more established markets.

"Our strategy is to stick with the proven technologies in onshore wind and solar," says Rintala, "but to leverage our in-house development and engineering strength to operate in geographies where there is perhaps less competition.

"Poland, where we're currently looking at deals together with partners, is a good example of where we can add more value with our technical team. Our other focus markets are the Nordics and Baltics, Spain and Portugal, and Texas, where we have a development team based in Dallas."

Despite a chequered history in recent years between Poland's incumbent government and renewables investors, Taaleri is not the only company attracted by the country's natural resources.

"We are also assessing new markets like Poland and other Eastern European countries, where the fundamentals make sense," says Wolfs, though Aquila is yet to make an investment in eastern Europe. "We typically invest in Europe where the resources are rich, such as the Nordics and Iberia."

Malik's Partners Group, however, is used to scouring the globe for relative value as part of its strategy. "For renewables, the first-mover advantage is important," she says. "We invested in a big solar platform in Japan a few years back. We have also been one of the first investors in European offshore and we are also active in Taiwan and Australia, which is currently the market where we see a lot of interesting and attractive opportunities."

Taiwan's recent offshore wind experience has made the firm wary though.

"We often see that there is a learning

> A lot of investors probably need to adapt to the new reality of an uncertain, unsubsidised world in combination with very cost-competitive proven technologies" **Wolfs**

curve when jurisdictions open up to new sectors of investments," says Malik.

Foresight is also exploring more opportunities in Australia and the US, albeit beyond the traditional renewables sectors.

"We started investing in battery storage in the UK and we see value opportunities on the flexibility side in Australia over the next one to two years," says Wells. Foresight is eyeing opportunities in the US, where, says Wells, "the regulatory environment is evolving quite quickly to become more favourable for things like battery storage".

It is also looking at certain European markets, such as Germany. "The learning we're amassing about investing in batteries and managing combined solar and battery portfolios will have application in emerging markets such as India in the not-too-distant future," he says.

Wells' enthusiasm for storage is a reminder that he was one of the few enthusiasts for its investment potential at last year's roundtable. So how do this year's panel members feel about the subject?

"It all depends on what kind of revenue stream and regulatory framework is underpinning it," says Wolfs, whose company owns one solar-storage asset (in Japan). "In Europe, there currently aren't many jurisdictions which have that [combination]. The UK used to, but now there is uncertainty."

Malik says that, as many standalone opportunities are not always investable from an infrastructure perspective, Partners Group is mainly assessing co-location sites with wind or solar where it makes the most economic sense.

"The market is waiting for the emergence of large-scale batteries that can cover hours and days," she says. "We don't think that will happen too far into the future, but until then, it's going to be quite opportunistic and case-specific."

For Rintala, storage is something for the future rather than the present. "We ask if storage capacity would actually help the performance of our existing

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portfolio," he says. "This does not work commercially today. Whether it works in a year, or two years, or three years, that's the debate, and we will keep an eye on it. As it stands, we would only go into storage as an add-on investment that would provide additional returns to an existing portfolio investment."

BATTERY POWER

Perhaps unsurprisingly, it falls to Wells to pick up the baton for storage.

"We would say that batteries can offer attractive returns as a form of 'short-duration' infrastructure asset," he says. "But there are risks that need to be carefully managed. It's not so much about the technology. We don't take any technology risk with batteries. Like any infrastructure asset, it's the contract that underpins it.

"And it's not so much about the battery in isolation, it's about understanding the system. Batteries are mostly still providing frequency-type services to the grid. There could be a much bigger application for batteries if they were to start to move from more niche ancillary services to providing meaningful amounts of multi-hour backup power.

"We're seeing in the US a real kind of progress in that regard. We would emphasise that you need to be very careful to analyse the contractual framework and how the assets fit within a suitably diversified portfolio when you're investing in batteries."

Although Wells says Foresight is looking at a range of assets in terms of generation, transmission and distribution, it is not currently looking at electric vehicle charging infrastructure. Credit ratings agency Standard and Poor's in March derided the asset class as "unprofitable and therefore unproven", and Wells has similar concerns.

"It's something we're watching closely and there is a lot interest and activity," he says. "But we haven't really found models to date that are particularly compelling from a profitability standpoint."

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There have also been concerns about whether grids can keep up with the wealth of renewables projects entering the system, as well as other energy-intensive infrastructure assets, such as data centres. Malik believes Partners Group's purchase last year, in a consortium with CDPQ and Ontario Teachers' Pension Plan, of energy-services provider Techem at an enterprise value of €4.6 billion, could offer a solution.

SUPPLY AND DEMAND

"The energy transition is twofold," she says. "On the supply side, renewable energy is substituting fossil fuel, while on the demand side, there is a need to be more efficient and more flexible. Techem is one of the larger players in the market and well-positioned to play a role in the energy transition in Germany and across Europe.

"Energy transition is definitely a key focus area for us and, with the pace at which the renewable energy build-out is occurring, it's becoming more and more important."

Wells believes storage can also play a role in this balancing act: "Storage can be used as a transmission asset by providing 'congestion relief' in bottleneck areas, particularly those close to renewable-power assets. It can therefore be a really effective way of incorporating high levels of wind and solar without having to build massive new transmission lines."

It is clear that the path to a cleaner and greener future still needs to be navigated. There remain substantial differences between the renewables industry and investors, between the industry and government, and between the industry and technology firms.

However, no one around the table disputes that there will be ample investment opportunities in bridging those gaps. As the market becomes more complex, the participants in our roundtable believe that organisations like theirs are best placed to do so. ■