SPECIAL REPORT

THE KEYS TO INVESTMENT IN RENEWABLE ENERGY IN THE US FROM 2021 ONWARDS

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FINANCING WIND
INSIDE INVESTMENT

TAMARINDO GROUP

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Executive summary

It's an interesting time for renewables in America. The country has just had election where clean energy investment was a central policy issue. And the winner was the candidate with the greenest agenda. The election outcome bodes well for renewables. But challenges remain.

It is yet to be seen how President Biden's policies will fare, and even with bipartisan support, there are questions over how the market will deliver the kind of growth now needed to meet global climate goals.

One example: US renewables has got where it is now largely thanks to tax incentives. But in 2020 the solar sector's growth started to outstrip available tax equity. Utility-scale solar has grown 66% more in 2020 than 2019, creating a requirement for up to $8 billion of tax capacity from external investors, according to Wood Mackenzie.

To address challenges such as this, in December 2020 the law firm Latham & Watkins led a closed-door Wind Investment Boardroom round table meeting with 10 leading figures from all areas of the US renewables value chain.

The session, held on the eve of A Word About Wind's Financing Wind Inside Investment 2020 conference, focused on three issues:

- What should the incoming administration do regarding the energy transition and to what extent are tools such as tax credits still needed?
- What role can equity play in the transition, what is the best point for private capital to enter renewable markets and what can be done to address competition for equity?
- How can the industry accelerate technologies such as hydrogen and carbon capture, and how do returns in renewables compare to sectors such as oil and gas?

This paper summarizes the main points discussed.

Introduction

It's probably fair to say that the US renewables industry had been having a relatively lucky 2020 even before the outcome of the election. The resilience of the sector in the face of the coronavirus pandemic helped to buoy its outlook within the investment community.

In July, when the US was seeing more than 50,000 new coronavirus cases a day, the American Council on Renewable Energy put out a report on finance that showed investor confidence in renewables growth was as high in 2020 as it had been in 2019.

Those with the most confidence in the market were those looking to invest $500 million or more into the industry – the highest spenders. And 94% of investors said the US was going to be as attractive as anywhere else in the world for renewables investment between 2020 and 2023.

Only 15% of respondents were planning to cut their investments in renewables, while 53% percent planned to increase investment by more than 10%.

This investor sentiment has already led to some historic energy industry milestones, with a renewables company, NextEra Energy, overtaking oil major ExxonMobil to become the most valuable entity in the sector in October.

And Goldman Sachs has forecast that renewable generation will be the largest area of energy spending in 2021, overtaking oil and gas for the first time in history. But renewables will need all the help it can get if the US is to meet a climate goal of net-zero emissions by 2050.

"Renewables has held up remarkably well as an asset class throughout COVID," observes Latham & Watkins Partner and Co-Chair to Energy & Infrastructure Group, Eli Katz. "And certainly it's the case that a Biden administration is a net positive."

However, he adds: "The Biden administration doesn't have as much of a mandate as people might have hoped. The senate, at best, will be 50:50. So it is entirely possible that some of the Biden administration agenda gets held back a bit and has to be horse traded."

The task ahead

Biden's first task will be to control the coronavirus pandemic, Katz believes. So it remains to be seen how much can be achieved in terms of energy policy during 2021, before election concerns again muddy the waters.

The most obvious way to support renewables is through some sort of infrastructure initiative, which could garner bipartisan report. Katz predicts "nothing earth-shattering" but says the renewables industry can at least expect a more supportive administration.

Ravina Advani, head of energy, natural resources and renewables at BNP Paribas, says there had been a growing trend towards investor alignment with climate goals even under the previous administration. "Many of my clients are under constant pressure," she says. "A lot of the oil and gas companies are under scrutiny."

That's leading to a growth in conversations about energy transition. BNP Paribas is now being "very judicious" about its investment goals, Advani says, and is seeing booming private equity and infrastructure fund interest in asset classes such as renewables.

Developers are also seeing a change. At Scout Clean Energy, CEO Michael Rucker is hoping to see growing investments in transmission, in particular. This is a major bottleneck for renewables development. "Unless we address the transmission bottlenecks, we're not going to meet the expectations of the market," Rucker says.

Storage is another area where there might be bipartisan support, he says. There is hope for a standalone tax credit for storage. Elsewhere, offshore wind certainly looks set to benefit from the new outlook.

"We will probably see a more positive trend with the new administration," says Lars Thaaning Pedersen, co-CEO of Copenhagen Offshore Partners. "Some of these projects have just been lingering too long."

Financing the transition

Overcoming regulatory hurdles is going to be a major challenge for financing US renewables, Pedersen says.

Failing to deal with this problem is key to the incoming administration and could leave the US in danger of not only missing its own climate goals but also missing out on global industrial opportunities.

This is the case with floating offshore wind, a technology that is gaining traction worldwide and "is competitive" today, says João Metelo, CEO at Principle Power.

Fostering such technologies could lead to "real serious opportunities" for areas such as the Gulf of Mexico, which is stagnating as the oil and gas sector recedes, Metelo says. Financing the transition is not just about energy, he adds, but also transportation, where there are opportunities for hydrogen as well as electrification.

Fortunately, regulatory support is already being driven aggressively at state level, says William Demas, managing director of Stonepeak Infrastructure Partners. But for emerging technologies in particular, policy so far "hasn't really done anything to get investors excited or make it easier to deploy capital."

There needs to be a better environment to deploy capital, he says, for example by offering more stable or visible cash flows for projects. "That's the biggest constraint," he comments. "People can't take revenue risk and technology risk" at the same time, Demas says.

Justin DeAngelis, partner at Denham Capital, notes how this limitation is pushing investors to focus on wind and solar. Yet "tax equity creates an additional layer of friction and cost for financial players who don't have a need for the tax losses," he says. "You don't really need as much of subsidy to make it happen."

Even with a perfect regulatory environment, there still needs to be projects that investors find attractive. This is one big draw in offshore wind, where technology risks and costs have fallen as permitting of US projects has dragged on.

Accelerating technologies

New financial tools will likely be needed to mobilize the kind of money that is required not just for continued solar and wind growth but also for the buildout of transmission and new technologies such as green hydrogen and carbon capture, utilization and storage (CCUS).

One option is royalty investments, a model that is well known from the oil and gas sector. Here, financiers fund development and then take a royalty off the project. "There is a wall money there but most of it is looking for de-risked value," says Frank Getman, President and CEO at royalty financier Great Bay Renewables.

"There's been little innovation on the financing front," he says, and this needs to change.

Brandon Sack, managing director for clean energy development at Evergy, says the scene is set for wind, solar and battery storage to scale up without subsidies. One missing piece of the equation is hydrogen to replace carbon fuels. "There's plenty of opportunity locally to produce hydrogen," Sack says.

Justin Stolte, Partner and Co-Chair to Energy & Infrastructure Group, Latham & Watkins, likens the current excitement around US renewables to the interest in unconventional hydrocarbons a decade ago. That's a segment that has recently faced headwinds, he notes, making it important that renewables investors see returns on investment matching these excitement levels.

The energy transition "certainly has the interest of policymakers," he says, but "the transition is a marathon being run at a sprinter's pace, so continued policy support, as well as execution by the industry, will be key."

Oil and gas players can and should be part of the solution, Stolte says, particularly in areas such as CCUS, which is emerging as a potentially key contributor to deep decarbonization.

The good news is that large investors are standing by to support many of the potentially transformational technologies that are still nascent today. At BNP Paribas, for example, "the bank is laser-focused on hydrogen," says Advani.

Conclusion

Investors are ready and eager to invest in US renewables. Technology developers are keen to get projects up and running. And now there's an administration that has the energy transition as a key priority. What else is needed for the US to meet its climate ambitions?

"It's the marketplace design," believes Pedersen at Copenhagen Offshore Partners. "It's not set up to enable investments. I cannot see how that can be solved if not at the federal level."

It is an issue that needs to be addressed quickly. If an investor sees friction then they will deploy capital elsewhere, says DeAngelis at Denham Capital. "It's a risk allocation question," he says. "If you want to put new technologies forward, you need better risk allocation."

The marketplace design also needs to address the funding gap between technology development and infrastructure finance and, importantly, how renewables can cater for merchant risk. "We've made solar and wind relevant and almost boring," says Demas at Stonepeak Infrastructure Partners.

As a result, he says: "I would expect that the return profile between renewables and oil and gas is going to converge. The cost of capital is going to increase. It's about having a sophisticated approach to how you are going to manage merchant risk."

What's required is "someone looking at it holistically," says Getman at Great Bay Renewables, "but it's working."

Ultimately, and despite the increased certainty that has come with the election outcome, the US renewables community still needs further clarity to achieve the ambitious goals of the Biden administration.

Asked about what they wished for 2021, the experts at the Wind Investment Boardroom wished for clarity in terms of integrated system operator plans, improved offshore permitting and electric vehicle standards. "If I could ask Santa for one thing, [it's] a crystal ball," says Sack at Evergy.

If you'd like to find out more about our Wind Investment Boardroom programme **click here** or get in touch with the team:

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