

Green infrastructure working to unlock institutional capital

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With the majority of the green sector's capital required for large infrastructure projects, it is essential for institutional investors to be persuaded of the viability of the next generation of alternative energy investments. For those institutional investors in search of long-term, stable returns, the solution could be found in new energy infrastructure, despite their relative unfamiliarity to the sector, according to David Richardson, managing director and CEO of US private equity firm Global Energy Investors (GEI).

GEI describes its approach as 'project equity', making private equity-style investments into renewable power generation projects, as it aims to tap into the considerable capital available to private equity fund investors.

Richardson says, 'Our business strategy is to take ownership interests in fully permitted, fully operational, commercial-scale wind and solar projects in the north-eastern and mid-Atlantic regions.'

'We want to focus on the lowest risk sectors of the renewable energy markets, investing in operating projects built by proven developers, using proven technology, and that have proven energy resources with long-term contracts for the sale of the power generated,' he adds.

The firm targets medium-sized projects within the \$5m to \$25m range, rather than the larger-scale, more capital-intensive projects. The approach is a good fit for the type of installation being undertaken in the firm's chosen region of the north-eastern and mid-Atlantic regions, Harper says. Aside from a few headline-grabbing megaprojects such as the 420MW Cape Wind project off the Massachusetts coast, the region's resources generally preclude the scale of renewable energy projects being undertaken in more expansive regions such as California and the Midwest.

However, smaller projects have traditionally found it difficult to secure project finance, as they can be as complex to undertake as larger installations, but lack the economies of scale that bigger projects can access, Harper explains.

'Almost universally, we find that the larger, utility-scale projects costing hundreds of millions of dollars, can obtain

Investor Profile: Private Equity David Richardson, John Harper Global Energy Investors

project financing for their projects. Many of the large banks are still lending for strong projects.'

'In contrast, where the financing market is much more difficult is in energy projects under \$50m. For these sized projects, the transaction costs really have to be minimised, and traditional project finance is harder to do at this scale,' he adds.

Smaller project developers can also find it difficult to

access institutional investor funding, as many of these large organisation have a mandate to allocate considerable amounts of capital. Also, with larger projects taking the same amount of time to review as smaller projects, investors often prefer to allocate to one big project as opposed to a number of smaller ones. One way GEI aims to accelerate the process is to streamline the financing procedures.

Harper says, 'A much better business model is to initially purchase these medium-sized

projects with equity, and without project financing. Then, after we have assembled a diversified portfolio of operating projects producing steady income streams, we can refinance the project portfolio. The scale of the financing will allow the bank financing to be done efficiently.'

With such a wide field of project developers having difficulty accessing conventional financing sources, the firm has identified some two dozen developers in their chosen regions that fit its criteria.

'We are looking for developers who know what they are doing, have been doing it already, and are able to do multiple projects. What we are finding is that there are new-to-market developers coming over from other sectors such as commercial real estate development. Sometimes they understand their limitations and that they need to bring in that energy expertise,' says Harper.

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John Harper (left) and David Richardson, Global Energy Investors

‘Other times they don’t know what they don’t know and they don’t really want to learn. Those are the people who are harder to work with. The most attractive developers are the ones that have been doing projects already at the scale we are looking at and they just want to do more of them,’ he adds.

The project equity approach could work especially well for investors such as pension funds, seeking to invest in long-term, large-scale projects providing steady, reliable incomes as part of a diversified portfolio, according to Richardson.

He says, ‘For people looking at this space, owning renewable energy projects is a lot like buying a high-yielding bond or annuity: in exchange for an upfront payment, owners of these renewable energy projects earn a steady coupon from the sale of electricity to utilities.’

The investment period could provide institutional backers with project equity and could also offer those investors a hedge against future market fluctuations.

‘The other advantage to owning renewable energy projects that sell electricity is that electricity prices are highly correlated with inflation. Investments in renewable energy

projects are an excellent hedge against inflation and investors here in the US are quite worried about future inflation,’ Richardson says.

GEI’s strategy may be a sign of the growing maturity of the clean energy sector, moving beyond early stage investment, and appealing to capital-rich, risk-averse investors who may have viewed cleantech as the latest potential technology bubble.

Richardson says, ‘This may not be as sexy as financing the next algae fuel, but if renewable energy is to grow, if we are to make a difference in our energy mix, we have to find ways to persuade conservative investors to deploy capital, and lots of it into this space.

‘Our industry needs to offer investment strategies that are

designed to meet the institutional demand for conservative, income oriented strategies around real, stable assets.’

The trick, says Harper, is to balance the long-term lifespan of these projects with the shorter-term expectations of their backers.

‘The projects themselves have very long lives, between 20 to 30 years. We are looking for projects that are designed in a fashion to realise that equipment life. Some projects are more geared to shorter financing terms than others. We find that investors are interested in seeing a return on their capital inside of ten years.

‘The work we do is trying to balance those two things – one is a project that is built to last a long time, and the other is the desire of investors in projects to realise a return inside of ten years. We are finding projects that achieve that balance,’ he adds.

While bold investors accept the inherent risk-return of some of the earlier-stage opportunities, there is a pressing need to bring large, conservative, risk-averse investors to the next stage, according to Richardson.

‘When you step back and think about renewable energy

investments, you have to recognise that most of the capital that is needed is to finance the development of renewable energy and infrastructure projects, to produce and sell electricity.

This opportunity absolutely dwarfs the amount of money that will ever be realised from venture capital investments in this space,’ he says. ‘If the capital requirements are that enormous, we must find ways to get institutional investors excited about committing tremendous amounts of money. They are not going to do that in size for high-risk venture plays. For sizable investments, institutional investors require safety and stability. For these types of investors, owning renewable energy projects within a diversified portfolio is the right answer,’ he adds. ■

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