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Investor interest in alternative energy continues, despite political meddling

By: David Walker | 05 Dec 2012

Christian Riemann, CEO, Global Investment Bridge AG

Europe's politicians cannot influence the weather, but their recent decisions on price tariffs and incentives are having some effect on those trying to profit from it by investing in solar and wind renewable energy plants.

For cash-strapped governments, subsidies for alternative energy producers are a luxury they can no longer afford. The subsequent interventions to cut the largesse have made some investors more conscious of the non-financial risks of dirigisme, although that certainly has not stopped overall enthusiasm for alternative energy investments. The field was boosted by $200bn of net inflows globally last year, helping asset volumes grow by 540% since 2004.

In the face of tight public finances, various governments have tinkered recently with the levels of state subsidies and tariff rates paid to generators that feed renewable power into national grids. Facing an annual tariff deficit exceeding €5bn, Madrid, for example, has eliminated incentives from next year.

Berlin is reviewing grid connectivity rates every month and accordingly revising incentives more regularly. Prague has adjusted subsidies in the Czech Republic retrospectively. And lawsuits over tariffs, filed by non-government organisations in France, have placed the system there "in limbo", according to one investor.

Downward revisions

Jason Mitchell, head of alternative sustainability strategies at GLG Partners, says there have been 16 unplanned downward revisions to solar subsidies in Europe since 2011.

"In the economic boom leading up to 2008, investment in sustainable areas, such as renewable energy is commonly viewed as a logical eventuality. Many of these areas, however, are proving vulnerable to economic shocks," he says.

Sunny southern Europe is home to the economies that can least afford to subsidise, so it is there that the fiercest battles have been fought between policy supportive of renewable energy on the one hand, and austerity on the other.

Italian regulators have introduced reforms including a one-off 'Robin-Hood' tax hitting the renewable energy green certificate scheme, while Spain's politicians tinkering with their system led solar investors there to file lawsuits claiming changes contradicted European directives.

Mitchell says: "Spain, Portugal and Italy are all dealing not just with the costs of a renewable hangover, but also with how to integrate these new costs into structural adjustment programmes that have already sparked political backlash."

Philippe Zaouati, head of the newly formed Mirova responsible investment division of Natixis Global Asset Management, says the industry, already in flux, is also in need of alternative financiers as Europe's banks reduce their involvement as lenders.

Christian Riemann, CEO of Global Investment Bridge (*pictured*) which organises renewable projects/investments for top-end retail and institutional investors throughout Europe, says: "One or two years ago it was no problem to get bank financing to develop projects. Today it certainly is a problem."

In the UK, Old Burlington Investments started up recently with an alternative energy fund; the Real Asset Energy fund is raising money for a fund partly for renewables; and Natixis's Mirova unit is examining projects in some Nordic countries.

Renewable energy practitioners argue their universe generally still makes sense as a long-term investment that can produce yields unavailable from much mainstream fixed income. Returns come primarily from selling the energy produced into the national grid, or selling it privately if preferred. But, in parallel, some investments can derive up to 25% of their total returns from selling carbon credits they receive for their environmental friendliness.

Riemann says investment is a realistic option from the level of retail, to syndicates pooling cash to finance larger projects, to private placements for limited groups of sophisticated investors, to institutions investing individually, for example via the Spezialfonds segregated mandate structures. Investors can choose to buy power plants that are already constructed, being operated, and connected to the grid with a tariff/subsidy set in stone; or they can buy into the company that runs the plant; or they can elect to finance the construction of the plant before selling, leasing, or running it.

Riemann can help investors with any variation on these themes. ”The IRR is much better if you can do the financing, but you are taking more risk. Other clients say they are happy to buy into a project to sell it, or own it. You can get an operational plant complete with engineers, contracts and maintenance and insurance. You buy the package, so you do not have to worry about the plant.”

Before investing, clients receive an independent survey that gives an assessment of the land, and provides statistics such as the amount of sunshine/wind in the location, the number of megawatts expected to be generated, and costs of producing each megawatt for the first year and net income expected, and the gross margin.

Connectivity crucial

Once clients are satisfied, Riemann says, the speed to achieve grid-connectivity is crucially important, because Berlin is reviewing its incentive structure, usually for downward revision, so regularly.

“You need to be really quick: if things are changing all the time, you cannot afford to sit and wait. If you are building the plant, you need a team that is technically competent to make them. They can be built in about three months, including permission.”

Once the subsidy/tariff is set for the project, it is guaranteed for 20 years - which happily is also typically how long manufacturers of the major components for solar and wind plants guarantee that performance of their products will be at least 85% as good as it was on day one. (Components are usually financed by their manufacturers, so investors do not have to pay for them immediately, but they may have to wait for delivery if the maker is in China or Japan.)

Luca Concone, chief executive officer of the Real Asset Energy fund, says it is important to understand and control risks of investing in renewable energy development funds, and he notes up to 60% of money in a fund that has too short a life can depend on being able to sell the hard asset at a decent price.

He dubs this an unacceptable ‘Las Vegas style bet’, not least because “knowing how much a wind power plant will be worth years from today would depend on a huge number of variables, none of which is under the control of the manager. The valuation by the market to buy the asset does not depend only on the asset, it depends on so many other variables.”

He adds that RAEF “plays in the lowest risk space of power production, where we sell electricity and buy [only] plants connected to the grid, with tariffs recognised and the contracts signed”.

As well as reducing risk in this way, he says diversification of investments – by country, plant type and size - is important.

Joyce Shapiro, Franklin Templeton Real Assets Advisors’ managing director of infrastructure and real resources, agrees: “Investors seeking high risk-adjusted returns from their

infrastructure and real resources investments should consider a strategy that seeks diversification across geographies, sectors, revenue models and stage of investment."

The public opinion tailwind for renewables

Europe's politicians may increasingly view public subsidies for alternative power plants as an unacceptable burden on the public purse, but their voters seem still to favour support.

Global Investment Bridge's Christian Riemann says: "We have seen increasing costs of energy and a strategic dependency on Russia or on warring Arabic nations, and there has been an incentive to get away from that, and build something that is autonomous and green."

In Riemann's homeland, Germany, utilities companies initially largely ignored the popular backing for alternative energy. The companies were buoyed by promises from Angela Merkel's ruling coalition early on in her tenure that the party would repeal legislation supporting renewables. Then came the explosion of Japan's Fukushima nuclear plant, hardening public resolve as far away as Germany, which is now moving to phase out nuclear power completely.

Riemann says: "The move towards green energy has been far more successful than anyone had imagined in terms of electricity production, and suddenly the 'doors to the zoo' are open. Even Germany's bigger power companies have realised their government might speed up the new laws."

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