KEYNOTE INTERVIEW

Energy transition takes centre stage

All the ingredients are in place for a stellar 2024 in the renewable energy project finance market, says Wilmington Trust's Will Marder

Now that market participants have had time to fully digest the intricacies of the Inflation Reduction Act and residual supply chain issues have finally been worked through, the renewable energy project finance market is in full swing. Meanwhile, the capital necessary to fund these projects is readily available from traditional commercial banks, institutional investors and both equity and debt funds.

One exception in the US market remains the offshore wind industry where cost and complexity continue to surpass opportunity, despite IRA incentives and efforts to streamline permitting. Another potential fly in the ointment is the upcoming presidential election. The market is quietly confident that no significant roll-back of the IRA will take place, but the hope, nonetheless, is for a president that supports the energy transition, says Wilmington Trust's head of project finance Will Marder.

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Q How would you describe project finance activity levels in 2023?

Financing activity really picked up in 2023 relative to the prior 12 months. In 2022, headwinds from the pandemic and supply chain issues in the renewable energy space still lingered. It felt like a transition year when everyone was still getting back on their feet. In contrast, 2023 felt like the first proper year of growth.

We saw developers with significant pipelines of projects reach the point at which they were ready to get financed. They had resolved their supply chain challenges and problems getting through interconnection queues, and reached a stage where they were ready to go out to the capital markets.

I think another contributing factor was the IRA, published at the end of August 2022. It took nine to 12 months for people to digest what that legislation really meant for their projects and for financing. Once all that information had been assimilated, they were ready to press go. At the same time, there has been strong supply of capital in the marketplace from multiple sources, including the traditional commercial banks, institutional investors, as well as both debt and equity funds.

Furthermore, although interest rates have increased significantly, spreads have remained attractive, which has meant borrowers have been keen to lock in financing. In short, projects were ready, capital was there and the cost of debt was not prohibitive, so everything came together to give us a very strong year.

Q Which sectors have been most active and what have been the key drivers?

We're an independent provider of trust and agency services, so we tend to follow the market in terms of technology, sector and structure.

The US marketplace has been heavily dominated by renewables. The focus has remained primarily on solar and wind, but we also saw strong interest in renewable natural gas landfill gas utilising methane, for example, as well as biogas and anaerobic digestion projects. We saw a lot of activity in the liquefied natural gas (LNG) space. Some very large LNG projects closed in 2023, which we were happy to be involved with.

On the flipside, however, we had had high hopes and expectations that offshore wind would finally gain some traction in the US market in 2023, but that didn't happen. There was some successful activity with the Vineyard Wind project, but I believe that was the only one. In general, the offshore wind market was characterised by a pullback as cost and complexities outweighed whatever forward momentum those projects had.

Q How are you seeing the broader geopolitical and macroeconomic environment playing out, and what impact do you expect that to have on activity in 2024?

The geopolitical situation dovetails well with the global push towards renewable energy. The great thing about renewable energy is that it tends to be distributed. Power is produced wherever the natural resource is which means, in the case of solar, that wherever you have strong solar irradiance and insolation, you can produce electricity. Solar panels can be placed on residential rooftops and on large commercial and industrial buildings. It can also be built at utility scale, close to centres of demand.

Wind is somewhat different but is also relatively distributed. These renewable energy technologies can reduce the need for many countries to import foreign oil and gas. That is something that has become increasingly important, given the ongoing war in Ukraine which has had a massive impact on Russian gas exports. Meanwhile, the conflict between Israel and Hamas is having an impact on ocean-going traffic in the Red Sea, creating challenges for shipments of oil and gas plus other cargo. The concept of energy security and energy independence has become a key priority for governments. The timing is perfect for a push into renewables, which solves so many problems.

The IRA contains lots of beneficial provisions for the sector and the Biden administration has really tried to streamline the permitting process so I do think offshore wind will come back. But I don't think that will happen at scale in 2024. I think it may be two to three years off.

Q Do you expect to see a pickup in activity around newer areas of the energy transition?

There is a lot of interest in hydrogen, as well as carbon capture and storage. But I see those very much as emerging technologies. I do think you will find capital that wants to get behind those projects, but we are not seeing anything of scale yet, so I don't think those sectors are really going to hit the project finance market for at least another three to four years.

Q What impact is the energy transition having on the

project finance market more broadly?

The energy transition is a global phenomenon that I believe is going to have a very positive impact on the project finance sector. In December, the COP28 meeting in Dubai brought together all the nations that are signatories to the 2015 Paris Agreement, which outlined the intention to limit global warming to no more than 1.5C above the preindustrial era by 2050.

Those nations agreed that in order to try and slow and ultimately reverse global warming, first, we need a rapid acceleration in the roll-out of renewable energy and, second, we need to promote energy efficiency. Specifically, the "global stocktake" that took place at COP28 found that in order to hit the 2050 target, we need to triple the global capacity of renewable energy, double the rate of energy efficiency improvements, reduce methane emissions and transition away from fossil fuels. These four actions must be taken by 2030 in order to get on a pathway to reach the 2050 goal.

Those are huge undertakings that will require tremendous amounts of capital, much of which will come from the project finance sector. No doubt we will also see an increase in government funding from multilaterals and export credit agencies, but nonetheless a significant proportion will ultimately filter through to the project finance market. I see the energy transition as highly beneficial, and I believe we will continue to see a lot of activity around renewables.

Q Are the ESG debates likely to impact that trajectory at all?

It's interesting because I am hearing a lot more about the energy transition today and less about ESG. Part of that may simply be that the energy transition is the latest buzzword, of course. But while the environmental, social and governance elements of ESG are still important, the energy transition appears to have become the driving force in project finance.

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That said, there are those who question whether the energy transition is an elitist movement. Moving home heating to electricity initially drives up costs, while electric vehicles can be expensive and not everyone has access to charging infrastructure. There is therefore a recognition that the energy transition needs to be just and that nobody is left behind. We have to ensure that emerging economies are included, for example. The energy transition should have a positive impact on all regions on the planet and all socioeconomic groups.

Q What are your hopes for the year ahead and what could potentially derail them?

The market currently seems to be very bullish on renewables. We are hearing from both banks and institutional investors that they have large amounts of capital to deploy and that they remain highly focused on renewables and the energy transition more broadly. They are looking to offshore wind and battery storage technologies, for example, and are open to investment in hydrogen, carbon capture and renewable natural gas.

What will prove interesting, here in the US, is what happens in the presidential election. The hope is that the winner will be someone who is pro renewable energy and the energy transition and not someone that will seek to pull back on all that has been promised under the IRA. The market seems to think that that is unlikely, but there is still an element of wait and see.

Any negative impact is unlikely to be felt in 2024, in any case, as the next president wouldn't take office until 2025. If anything, it may cause a surge in activity as people try to get transactions done this year before a new president potentially arrives in the White House. Overall, though, I think the market is buoyed for another strong year in 2024, in a continuation of the strength that we saw in 2023. ■

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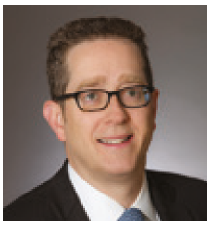

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