KEYNOTE INTERVIEW

Opportunities abound

Impetus from the Inflation Reduction Act and the sheer weight of money targeting sustainable investments is poised to generate significant renewable energy project finance opportunities, says Will Marder, managing director at Wilmington Trust

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Q How would you describe project finance activity levels for US renewables in 2022, and what were some of the biggest challenges the sector faced?
According to *Infrastructure Investor* data, the number of infrastructure funds that held a final close was down 15 percent year-on-year in 2022, despite the total capital raised reaching a three-year high at $162.33 billion. It has been reported that the overall market for syndicated loans declined in 2022, however the renewables sector fared better.

Infrastructure Investor data reveals that renewables recorded a 9 percent increase in its share of the fundraising market between 2021 and 2022. A decline in renewables is unusual, given that there has been a strong upward trend over the past decade.

One of the reasons for the decline involves lingering supply-chain issues. Some of the bottlenecks around raw material supply, manufacturing and transportation that originated in the pandemic still remain. We also saw rising equipment costs. Developers are used to seeing the prices of solar PV panels, for example, come down, but those costs actually increased due to the aforementioned reasons, as well as a tight labour market, which was a further constraint and encompassed everything from construction labour through to banking and legal professionals.

Meanwhile, rising interest rates were problematic. Base rates have stood at close to zero for a number of years, which made borrowing highly attractive. As those rates went up, developers had to go back to the drawing board to see if their projects still made sense. There was also the threatened Auxin solar panel tariff. The tariff was effectively put on hold by the Biden administration, but still did damage by causing solar project developers to press pause. Finally, there was high demand for tax equity financing which drove up prices. All these factors made it challenging for borrowers to raise the capital they required.

Q Amid all these challenges, the Inflation Reduction Act finally came to fruition. What

was the market reaction to its introduction?

The IRA was surprisingly resurrected in August 2022, essentially as a stripped down, less expensive version of the proposed Build Back Better bill. The market response was bullish; the IRA gives long-term tax benefits to the renewable energy sector in a way that hasn't been experienced before.

The legislation is highly complex, so while the market reacted favourably, it also meant everyone had to spend time analysing what it meant for their projects and how they could maximise the benefits available. For example, the IRA expanded the application of production tax credits and investment tax credits, meaning wind and solar developers had to revisit what made sense for them.

One real positive is the fact that the IRA also expands tax credits to new technologies – energy storage, microgrid projects and biogas, for example. There are also new or modified tax credits for carbon capture and sequestration, nuclear power, green hydrogen and sustainable fuels.

"There is a tremendous amount of capital out there looking to be deployed in a sustainable way"

Q Is there a danger that macro issues could derail focus on the energy transition?

I don't think so; these transactions tend to have a lot of momentum behind them. Developers spend years developing individual projects and building out their pipelines and so, while there may be delays, these projects do not tend to disappear. At the same time, there is a tremendous amount of capital out there looking to be deployed in a sustainable way. When you combine that with the impetus provided by the IRA, I think we are going to have a strong 2023.

Q When is the IRA likely to start impacting opportunities?

Initially, the expectation was that we would start to see some impact in early 2023, but I think that was rather optimistic. What we are currently perceiving is that it will take close to 12-18 months for participants to digest the implications, which means we should start see an impact by the middle to end of the year.

Part of the delay is that while tax credits have been extended and new tax credits introduced, they also come with additional hurdles around domestic content, for example. The location of a project is also relevant, as the IRA has introduced the concept of energy communities. This refers to brownfield sites where traditional power plants were located and could be redeveloped, helping to address unemployment related to the energy transition. There are also wage and apprenticeship requirements, so there are a lot of areas that demand scrutiny.

One of the most interesting elements of the IRA, where the market is still waiting on guidance from the IRS, involves the transferability of tax credits. Historically, tax credits could only be used by the direct owner of a project – the developer or equity partner. The IRA allows for the sale of tax credits to a corporate buyer, utility, or indeed anyone that has a taxable income. For certain non-profit groups and native American tribes, it is even possible to get a direct refund on those credits from the government.

This could all represent a huge benefit, helping smaller developers that might previously have struggled with the capacity to use these credits or enter into complex financing arrangements. This aspect of the IRA will allow these smaller developers to monetise the credits, but it is still unclear how it will work in practice.

Q To what extent is optimism derived from the IRA being tempered by broader macroeconomic and geopolitical challenges?

There is obviously a lot of discussion around global fuel pricing and there appears to be no end in sight for the ongoing conflict in Ukraine. That is creating interest in the development of additional liquefied natural gas export terminals in the US, as developers seek to fill some of the void left by Russia.

Interest rates will also continue to play a huge role in the financing of these projects. In some situations, developers are having to go back to their power purchase agreement counterparties to renegotiate prices when increases to their labor costs, equipment costs, or interest rates mean the projects no longer pencil out as they did just 12-18 months ago. There are certainly a lot of moving pieces that are outside the immediate control of the renewable energy project finance marketplace.

Q What emerging technologies do you find particularly interesting?

I think we are going to see a lot more standalone battery storage. I also think hydrogen production and storage is a largely untapped market poised for significant growth. We will start to see some carbon capture and sequestration, although these projects tend to be extremely large and complicated. I am unsure whether we will see any of these projects come to market in 2023, but I think we will start to see some projects getting teed up over the next couple of years. Renewable natural gas and waste-to-energy transactions are also set to grow.

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Q Are innovative structures taking place?

We are seeing early-stage financing for projects and equipment acquisitions. This is often called pre-construction financing. Historically, developers or equity investors have had to get projects to the notice-to-proceed stage before project financiers would get involved, but we are now seeing increased appetite from lenders to provide financing earlier in the lifecycle, helping to get developers to the point that they can then access more traditional construction and term debt.

We are also seeing more letter-of-credit facilities helping developers with power purchase agreement and interconnection support, as well as debt service reserves. I think we will soon see some kind of market develop around the trading of production tax credits and investment tax credits driven by the transferability provisions of the IRA. I am sure it will start out loosely, but it is only a matter of time before something more structured starts to take shape. I think that will be an interesting development.

Q What are your views on the expanded role of the US Department of Energy?

I think the DoE certainly has a growing role, even going as far as providing direct financial support for some of these emerging technologies such as hydrogen and carbon capture. Meanwhile, there may be other sectors where traditional lenders are looking for third party support, perhaps in the form of guarantees. The DoE has some great new people that have come from the commercial lending and investment side, who are providing expertise to the Loan Programs Office.

The DoE also has a specific focus on the coal-to-nuclear transition. Coal-fired power plants typically have good access to high-voltage interconnection and transmission in places that need power. Additionally, I think the DoE is going to provide momentum around grid reliability, resilience and security. In other words, making the electricity grid across the country safer and more stable in the face of extreme weather events, as well as the development of new transmission and the upgrading of existing infrastructure.

The Infrastructure Investment and Jobs Act also includes compelling initiatives around electric vehicle technologies, and battery manufacturing and recycling, so we will see interesting project finance activity in those spaces. In short, there are a lot of promising evolutions coming out of both the DoE and IRA. ■

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