KEYNOTE INTERVIEW

Joining the energy evolution

Energy and infrastructure deals are on the rise as transition-related themes boost activity. Wilmington Trust's Keith Reader considers how banks and investors are viewing opportunities and where they are more cautious

Global energy investment is set to surpass $3 trillion in 2024, according to the International Energy Agency (IEA), with two-thirds of this going into clean energy and infrastructure. However, despite these significant tailwinds behind the energy transition, the IEA warns that there is still much more to be done as it estimates that investment in clean energy needs to double by 2030 if the world is to meet COP28 goals.

Keith Reader, managing director and European project finance team leader of trust and agency service provider Wilmington Trust, outlines where he is seeing most activity in energy and infrastructure, where there are financing challenges and what comes next.

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Q Given the range of deals you see, what is your take on the energy and infrastructure market today?

It is an exciting market to be in. Alongside other areas, we have been supporting syndicated transactions in project finance, energy and infrastructure in Europe for 15 years now and so we get to see a broad view of the whole market. The energy transition is clearly a major trend for both energy and infrastructure, and deals in this space are trending upwards in EMEA, with some reports showing growth of as much as 15 percent by volume year-on-year from 2022 to 2023.

That growth will likely only continue as we see a strong pipeline of energy transition-related transactions in Europe, where government targets and legislation drive the economy towards low-carbon fuels and technologies, and in the US, where tax credits under the Inflation Reduction Act are spurring high levels of activity. We are

also still seeing oil and gas deals as well as telecoms, data centres and transport, so there is a good mix of transactions happening.

The strong growth potential is one of the reasons we have now created a specialist team that focuses on project finance, energy and infrastructure deals here in Europe, which we launched earlier this year to complement our strategy in the US. Clients increasingly need specialist administrative expertise on these transactions and they are looking for agents that can add value through the relationships they build and the overview they have of the market.

Q Within the energy transition, what is making you particularly optimistic about the prospects for deals in the near to medium term?

A really good example is the UK's departure from coal. At the end of September, we saw the UK's last coal-fired plant shut down. The country is leading the way here – it is the first G7 country to eliminate coal from its energy generation and that sets a benchmark for others to follow. Of course, it hasn't happened overnight. It was back in 2015 that the energy and climate secretary pledged that the UK would end the use of coal power in the UK within a decade, and it has come to fruition.

That has only been possible because of government policies that support investment in, and growth of, renewables, which now contribute 50 percent of the UK's energy supply. The first quarter of this year, for example, was the second quarter in a row when wind generated more electricity than gas.

That is only going to keep growing – there was a recent CFD auction in the UK for 131 new wind projects that will bring 9.6GW of capacity, for example. The UK government has also brought forward its target of fully decarbonising the power sector by 2030 and to meet this, it has indicated that it will double onshore wind capacity, triple solar and quadruple offshore wind.

Q Data centres have a clear link to energy transition. What key trends are you seeing there?

As technology continues to develop rapidly – AI especially – the demand for data centres is on a steady upward trajectory. The financing structures that support data centres are quite interesting in that they are often a convergence of project finance and real estate finance. Each deal is unique and so the financing tends to be bespoke – there is no one-size-fits-all.

It is a great example of how industries and technologies are converging and colocating, which can lead to many different ways of structuring these deals. In data centres, for example, you have renewable energy sources co-located to power the assets, which gives rise to behind-the-meter projects.

There are also interesting developments in other European markets. All this gives rise to huge opportunity for financings in the coming years. We see this as a once-in-a-lifetime opportunity in demand for capital investment.

Q A key element of the energy transition appears set to be battery storage. How is that space developing?

Battery storage will be essential to mitigate against the intermittency of renewables, especially if you don't have a stable base load that coal or other energy sources might bring. They clearly provide a material benefit of grid stability and supply smoothing, but they also bring a pricing benefit.

We are seeing battery operators purchasing and storing energy when it is abundant and cheap to discharge to the grid at higher prices when generation is lower and demand higher. That price arbitrage is attractive to developers and so the deal pipeline is strong. Yet

there are challenges. Among these are the complex offtake arrangements and revenue models. The guaranteed revenue models are short-term, so that brings in an element of exposure to market risk and therefore investors and bankers are cautious about this. However, we are hearing that lenders are increasingly accepting of some merchant risk in battery projects.

Also worthy of consideration for lenders and investors and project bankability are the engineering, procurement and construction (EPC) arrangements. Usually, structures benefit from a single EPC contract so there is a single point of responsibility for all three aspects of a particular asset, but in batteries, equipment procurement weighs heavier than engineering and construction, so we are hearing of developers looking to split EPC responsibilities, awarding separate contracts for procurement as a way of driving value.

This tends to be developers with a strong pipeline of battery projects as it means they can negotiate procurement for all their sites under one agreement. Yet the flip side is that this can give rise to issues such as delays and co-operation risks. Investors need to get comfortable with this.

Q Where else are you seeing obstacles, or perhaps less appetite, in the energy and infrastructure market?

Electric vehicle (EV) charging is an interesting area, although there is some nervousness in the market about destination charging, such as at supermarkets and car parks. One issue is the slowdown in new EV sales, but another is that destination charging isn't yet proven beyond locations such as motorway service stations. It is not clear that people want to wait for their vehicle to charge in some of these places. However, once this market has matured, investors will become more comfortable.

There is also some nervousness in fibre. We have seen a large syndicated loan get stuck recently – it just hasn't been as successful as anticipated. The problem here is that larger fibre deals tend to be more attractive because loans usually have better terms than on smaller deals. Yet fibre is an area full of smaller businesses. So, I think we will see some consolidation here.

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As I mentioned earlier, we are seeing some transactions in oil and gas, particularly LNG, and believe we will still see deals in this sector for some time to come. The appetite and liquidity is mainly in the US among institutional investors. European banks, by contrast, have strong mandates to move away from oil and gas and so we see less interest from them.

Clearly, we have also seen a dip in infrastructure fundraising, although there is still liquidity in the market from infrastructure funds with dry powder, which are ready to invest in the right deals. Overall, there is more confidence among lenders as the tighter margins we have seen in recent years, especially in renewables, are starting to ease.

Q How do you see the energy and infrastructure market developing over the medium to long term?

One near-term development we are seeing is a rise in bond financing. We have seen these instruments used more in the US over the past three to four years and now Europe is following suit by tapping into the US market for liquidity.

Supply chains in renewables remain a challenge that will need to be worked through over the coming period because it has a knock-on effect on projects' bankability. The current wait for offshore service vehicles to build wind installations, for example, is two or more years, while solar equipment can take up to two years to come through.

Further out, there is strong potential for some of the emerging technologies that aren't quite bankable yet. Hydrogen is one example. It has been talked about for a long time and we see some infrastructure firms establish dedicated funds, but banks are still wary about the technology as it is currently expensive and in its early stages.

Over time, hydrogen technology will develop and costs will reduce, but it will require governments and development institutions, such as the European Investment Bank, to take the early-stage technology risk and help the market evolve, much as happened with wind. It will become more attractive to investors and banks as it matures and the investment case becomes clearer.

The other big area will be carbon capture and the UK government has just announced $22 billion to support these projects. That government support will be critical to get the technology proven and for projects to be viable. But once that happens, there will be huge opportunities for investors. ■