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Bringing the energy transition home

Regardless of whether the Green Deal industrial plan restores Europe's place as a frontrunner in the fight against climate change, it will certainly create investment opportunities, five infra professionals tell Amy Carroll and Kalliope Gourntis

Recently, European Commission president Ursula von der Leyen heralded a new phase for the European Green Deal, focusing on industrial policy. The shift in emphasis is supported by a package of legislative proposals designed to stimulate a home-grown energy transition, in response to concerns that Europe is losing competitiveness with China.

"From wind to steel, from batteries to electric vehicles, our ambition is crystal clear," von der Leyen declared. "The future of our cleantech industry has to be made in Europe."

Could stage two of the European Green Deal spell a fresh wave of opportunities for the region's infrastructure investors?

Maximilian Lindner, partner at Antin Infrastructure Partners, says: "Over the past few years, the geopolitical environment has become much more complex and uncertain, with the Russia-Ukraine war and the covid-19 pandemic clearly highlighting Europe's vulnerability to global supply chain disruptions.

"As a result, we are seeing increased policy support across the EU for reshoring critical elements of supply chains in industries that are deemed strategically important.

"The German government, for example, has earmarked billions in subsidies for the construction of semiconductor production facilities. There is also significant European-wide political will to bring solar panel production back as well as to increase the EU's battery manufacturing capacity overall.

"This could potentially create some compelling opportunities for infrastructure investors to partner with industrial companies to create new production facilities, although it is important that the downside for the infrastructure investor is protected appropriately.

"It is an interesting trend but one that comes with its own set of complexities that need to be analysed and managed carefully."

Philip Kent, chief executive at Gravis Capital, questions the extent to which such deals would carry true infrastructure characteristics.

"I think it is important to make the distinction between funding the roll-out of solar and the manufacturing of solar," he says.

"The EU has a stated intention of capturing market share of supply chains from other geographies. With everything that entails, the risk/return profile of investing in such supply chains is likely to look a lot more like private equity than infrastructure."

Justin Webb, head of investment solutions at PATRIZIA, meanwhile, is sceptical that any policy initiative could bring solar panel manufacturing back to European shores in a meaningful way at this stage. "I think the horse has bolted on solar. Virtually all production is now based in China, and they are looking to almost double capacity from 500GW in 2022 to 950GW by the end of this year.

"Europe is aiming for 30GW by 2025. In the US, the Inflation

Zeynep Lucchini Gilera
Investment Director, InfraVia Capital Partners

Lucchini Gilera is part of the infrastructure investment team at InfraVia and sits on the investment committee. She focuses on origination and execution of transactions, particularly in the telecom, renewables and education sectors. She previously worked at KPMG Corporate Finance.

Saket Trivedi
Partner, Cube Infrastructure Managers

Trivedi is the partner in charge of Cube's energy transition platform. He joined the firm in 2020 and is a member of the firm's management and investment committees. Trivedi has more than 20 years' infrastructure M&A and industry experience. He previously worked at Evercore and Goldman Sachs.

Philip Kent,
Chief Executive, Gravis Capital

Kent joined Gravis in 2015 and is a member of the investment committee. He joined from Foresight where he was responsible for investments in the waste and renewables sectors. He also worked as a consultant within PA Consulting's energy practice and in risk management and clean energy at Gazprom Marketing and Trading.

Maximilian Lindner
Partner, Antin Infrastructure Partners

Lindner joined Antin in 2013. He holds board seats in a number of portfolio companies including Eurofiber, Blue Elephant Energy, Lyntia, Pulsant and European Rail Rent. He was previously at Oakley Capital and the telecom, media, entertainment and technology team at Macquarie based in London.

Justin Webb
Head of investment solutions, PATRIZIA

Webb leads the Investment Solutions Group at PATRIZIA and is responsible for infrastructure research and developing and managing infrastructure investment risk management strategies for PATRIZIA's investors. He was previously with Whitehelm Capital before PATRIZIA's acquisition of the firm.

Reduction Act is only looking to stimulate around 85GW per year of solar. There is simply no comparison."

Webb does see more of an opportunity in the wind turbine space, however. "We are seeing substantial tax breaks being proposed in the IRA and companies such as Vestas and Siemens are considering shifting their manufacturing capabilities. One reason that could keep them in Europe, however, is the fact that the European end market is so strong. Manufacturers want to be close to where the demand is."

The nearshoring policy push is also creating positive momentum behind other infrastructure sectors, according to Saket Trivedi, partner at Cube Infrastructure Managers. "Reducing dependency on external sources is positive for sustainable transportation, including electric vehicle charging infrastructure. It is also proving positive for waste management and recycling facilities, particularly those using organic waste to produce energy."

For Zeynep Lucchini Gilera, investment director at InfraVia Capital Partners, meanwhile, the energy transition is dependent on securing access to critical metals. "The complex geopolitical environment threatens some of these metals' supply chains and raises sovereignty issues."

This is the backbone of the Critical Raw Materials Act, announced by von der Leyen in her 2022 State of the Union speech, to address the EU's dependency on imported critical raw materials.

"Our response to the disruption taking place in the energy sector has been to launch a dedicated critical metals fund earlier this year to address this massive opportunity," says Lucchini Gilera. "That fund will invest through the critical metals value chain from extraction to processing and recycling. It is important that we take a holistic approach to securing the energy transition in Europe."

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>
> **ZEYNEP LUCCHINI GILERA**
> **InfraVia Capital Partners**

A green arms race

In many senses, of course, the Green Deal industrial plan is viewed as a direct response to the IRA in the US with global co-operation to mitigate climate change rubbing up against inherent national interest.

"Ultimately, climate change is a global challenge and requires co-ordination from everyone. We shouldn't be thinking about this in terms of a competition between Europe and the US. My hope and wish is that the EU Green Deal and the IRA can complement each other and help drive both regions forward in the right direction," says Trivedi.

"Having said that, depending on how quickly and effectively IRA funding is implemented, there is a risk that we will see a flow of capital and capacity moving to the US, and Europe will need to respond by creating additional incentives and a more supportive system. Some of those initiatives may be local in nature, given that Europe is made up of many countries, rather than the single big tax breaks we are seeing in the US."

"We are certainly seeing a green arms race going on between the EU and the US in light of the IRA," says Webb. "Both are trying to attract skills and capital to their domestic economies. This new phase of the Green Deal will hopefully stem some of those outflows. We are already seeing Hyundai, VW and Audi looking to move EV production to the US in response to the new legislation.

"There is no reliable way of predicting the price of hydrogen five, 10 or 20 years out. How can you deploy hundreds of millions of capex with no predictability of cashflow?"

SAKET TRIVEDI
Cube Infrastructure Managers

"However, the Green Deal is creating opportunities in Europe and helping to stimulate industries such as EV production. It's an area we see as having a lot of growth potential and we have just completed our first EV charging infrastructure investment in Germany sourcing locally manufactured fast charging systems."

On the whole, market participants are satisfied with the support they are receiving. Linder says: "As investors, we are looking for a rational, stable and predictable regulatory and policy framework, providing long-term visibility and support for the large-scale private investment that is going to be required to achieve the ambitious energy transition targets that have been set globally."

There are always improvements that could be made, however. "It often takes too long for EU or national legislation to translate into practical applications," he adds, pointing to perennial issues surrounding permitting and approvals.

Lucchini Gilera, however, says that what is required is a more holistic approach to policy in order to avoid long-term market distortions. "For example, if renewables are [EU green] Taxonomy eligible but the upstream component is not, that creates challenges. We need the critical metals required to facilitate the energy transition downstream to receive the same regulatory treatment as upstream renewables, otherwise you are driving demand away from the extraction of raw materials that are so desperately needed in order for the energy transition to be successful."

Waste-to-energy is another area not recognised as green by the EU Taxonomy, says Webb. "We think this component of the circular economy, which is promoting landfill diversion, has a key role to play in the transition but at the moment it is not Taxonomy eligible. That would definitely be on our wish list."

Trivedi, meanwhile, says he would like to see more support for energy storage, interconnections, energy efficiency and green hydrogen.

Green hydrogen conundrum

Green hydrogen has, of course, long been touted as the great white hope of the energy transition. But the path forward is far from clear.

"The UK's National Infrastructure Commission has recently ruled that hydrogen is not a suitable replacement for domestic gas boilers, for example. But where it can make sense, is where there is an economic source of green hydrogen and a ready-made offtaker nearby," says Kent, citing a wind farm that Gravis funds have invested in, located in Northern Ireland.

This plans to use curtailed electricity to create green hydrogen as an alternative fuel for a local cement production company, or for displacing the diesel used by its transportation fleet. "Where you have that exact match and proximity these projects can work, but when it comes to large scale deployment of hydrogen, I think the jury is still out."

Trivedi adds: "We have analysed dozens of projects but have struggled to gain conviction, as there is no reliable way of predicting the price of hydrogen five, 10 or 20 years out. How can you

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PHILIP KENT
Gravis Capital

"The ability to demonstrate value creation throughout the investment cycle is critical for fundraising. Managers that have fully realised multiple funds are better able to point to that track record"

MAXIMILIAN LINDNER
Antin Infrastructure Partners

deploy hundreds of millions of capex with no predictability of cashflow? The only answer is to secure an off-take agreement and those are hard to find.

"Where such off-take agreements are available, the price expectations of developers equate to single-digit returns for significant greenfield risk. In my opinion, without more government support, the green hydrogen sector will not take off in a meaningful way."

Green hydrogen today represents not even close to 1 percent of total hydrogen production, says Webb. "The space right now is incredibly narrow. We do see incentives coming online in Europe with Fit for 55 and RePowerEU and there has been around $320 billion of clean hydrogen projects announced on a global scale, up $80 billion from 2022 alone. However, for infrastructure investors, green hydrogen opportunities are still a way off."

The lure of the US

The IRA is not only luring manufacturers and developers stateside, it is also enticing LPs. But Europe does still have much to offer, says Trivedi, who points to its diversity: "Because Europe comprises many different countries with different levels of economic growth and development and different infrastructure needs, it offers more diversity than the US."

Webb adds: "We know that investors are looking to the US at the moment, but there are very good reasons why Europe remains attractive. One involves inflation protection. Everyone talks about matching inflation liabilities with inflation assets, but you need to make sure you are talking about the same inflation.

"While inflation in Europe and inflation in the US is highly correlated over the long term, it is ultimately different and can vary substantially over different time periods. If your liabilities are in Europe but your assets are in the US, then you are not entirely matched."

LPs also tend to have a home country bias, particularly when it comes to

infrastructure, helping maintain appetite for Europe. "These are social, long-dated assets and investors like that home jurisdiction narrative," says Webb. "They like to feel they are helping to build this new road or solar or wind park in their home country. It is something that resonates well."

"If you look at the economic fundamentals, there is a compelling investment thesis for Europe," says Lucchini Gilera. "This is a mature and well diversified infrastructure industry and Europe represents 25 percent of world GDP. We have a single currency and stable markets. I think Europe remains a very interesting opportunity for LPs to focus on."

Of course, an increased appetite for the US isn't the only challenge to infrastructure fundraising right now. The LP community is facing the double whammy of the ongoing denominator effect and profound liquidity constraints. A change in the interest rate environment has struck at the heart of infrastructure's appeal as well.

"We have two listed investment trusts focused on real assets and we are seeing capital moving out of alternatives and into more traditional sources of fixed income," says Kent. "Infrastructure has offered a great source of income over the last decade when gilts, corporate bonds and other money market instruments weren't. But now that situation has reversed and alternatives more generally will have to fight to remain relevant."

However, there are many positive attributes to infrastructure, in particular, in this turbulent macro environment. "Diversification, inflation protection, non correlation to market cycles, monopolistic characteristics: these are all good reasons to invest in infrastructure," Kent says.

"We as an industry just need to make sure we get out there and explain why infrastructure still represents more than simply a great fixed income alternative. After all, over the past few years of extreme volatility, when we have experienced high energy prices, covid-19, economic turbulence and two wars, infrastructure performance has remained resolutely strong."

The macro backdrop is also impacting relative appetite for different risk thresholds. "LPs are able to appreciate the protection that value-add strategies provide in the current environment," says Lucchini Gilera.

Lindner agrees. "The ability to demonstrate value creation throughout the investment cycle is critical for fundraising. Managers that have fully realised multiple funds are better able to point to that track record."

Webb, meanwhile, alludes to the potential that the private wealth market represents for the asset class. "I think that is something that has, until recently, been really overlooked. Despite accounting for approximately half of global wealth, private investors only account for 16 percent of all investment in private assets.

"The new European Long-Term Investment Fund structure in Europe will no doubt help facilitate private investors' access to alternatives, broadening eligible investments, making diversification, concentration and borrowing limits more flexible and lowering minimum ticket sizes.

"GPs that embrace these structures will open the door to a whole new world of capital and I think there will be a real first mover advantage. That could prove critical as institutional fundraising is incredibly tough right now." ■

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> **JUSTIN WEBB**
> **PATRIZIA**