Renewable energy trends in Europe

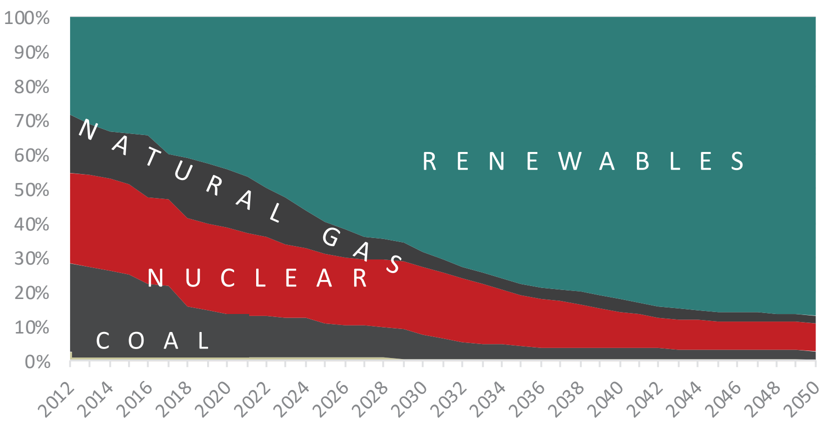
Capital Dynamics shares its perspective and insights on how the global energy infrastructure landscape has evolved and why there is reason to be optimistic about the opportunities for renewables in Europe.

The pandemic re-enforced renewable assets as being highly uncorrelated to GDP and other asset classes. Renewables set records in 2020, adding nearly 90% new renewable power capacity globally. We expect the secular changes taking place in the power market with the energy transition to not only continue, but to accelerate as we look ahead. Investors seeking assets that have resilience can look to contracted renewable projects as a stable (and yielding) alternative.

The steady performance of the sector, increased focus on ESG, and the desire to invest in themes supported by governments globally has led to greater investor interest in renewables and more managers entering the space for the first time, creating potential risks for investors. We have noticed an excess of equity flows towards the easiest entry points in the renewables sector. Accordingly, we believe it is important to move away from these overcrowded segments of the market and direct more focus on proven, harder to replicate strategies that can offer more upside as well as longer-term offtake contracts.

The first half of 2021 has proven to be the beginning of another very exciting period for renewables in Europe. However, with the maturing of the industry, deep and focused expertise will be required to achieve success.

Europe's energy market mix



Source: Bloomberg New Energy Finance, October 2020.

1. Growing momentum will continue to drive the European energy transition

With ambitious coal retirement targets and a strong stance on climate change, we expect Europe to continue leading the global energy transition. European countries are accelerating coal phase-outs through legislative targets, while the UK is targeting to fully phase coal out within the next three years. Furthermore, emissions limits are forcing coal operators to upgrade equipment or retire, while nuclear capacity growth is projected to remain soft as older plants close and new capacity plans stall.

Industry experts estimate that renewables will supply in excess of 80% of European electricity by 2050. Declining technology costs continue to improve the competitiveness of renewables against conventional alternatives, and falling costs of battery storage will allow increasing capacity of larger renewables assets to provide base load power.

The momentum behind renewables is further enhanced by the surge in multinational corporates seeking to fulfil 100% of their long-term power requirements from renewable sources. The Climate Group's RE100 membership continues to rise to over 280 members and corporate demand for renewable energy is likely to increase further, with household brands announcing their commitment to sustainability. Value can be generated by sourcing long-term contracts that match these large corporates to deals accessed directly from developers. Such contracts with creditworthy counterparts provide a guaranteed contracted price, cushioning the assets against market turmoil, and providing long-term, de-risked cash flows for the entire contracted period.

2. The policy environment will remain accommodating

Governments across Europe continue to signal strong support for renewables. In the UK, ahead of hosting COP26 in November, the Prime Minister set out a ten-point plan for a green industrial revolution to 'Build Back Greener' through clean wind energy – creating jobs, slashing carbon emissions and boosting exports. In the EU, the European Green Deal and various green stimuli packages were announced totaling tens of billions of euros to support a sustainable recovery and to continue its drive towards the target of net zero emissions by 2050. At the recent G7 conference, leaders committed to supporting a green revolution that creates jobs, cuts emissions and seeks to limit the rise in global temperatures to 1.5 degrees. Decarbonisation of European energy supply will be crucial to achieving these targets.

For nearly two decades, the European renewables market has benefited from attractive state subsidies, which has encouraged significant levels of investor capital to the sector and brought the industry, at large, to maturity. Fast-forward to today, and technology costs have fallen to a level where high quality and efficiently operated projects can now compete with more conventional forms of power generation without the need for subsidies. In response to these changing economics, state governments have begun to reassess traditional subsidies in favor of 'softer' measures, under the auspices of the European Green Deal, such as a more accommodative local permitting environment, wider grid infrastructure upgrades, and local tax incentives. Understanding how these shifting incentives will impact clean energy markets, in tandem with technological expertise, price hedging capabilities and operational efficiency, has become increasingly important to securing and delivering attractive investments in this new landscape.

3. Specialist knowledge and relationships matter

As the corporate PPA market continues to evolve in Europe, and interest in the utility PPA market continues to grow, high quality long-term power purchase agreements represent the most attractive solution to hedging long-term power price volatility. With each European country in a slightly different stage of their market transition journey, only a specialist investor with regional expertise is able to access the most attractive market-specific opportunities and negotiate optimal structures. As the pool of PPA participants grows, we are able to leverage the relationships across the region to contract with bankable, reliable counterparties.

ESG focus

Carbon emissions peaked at record levels over the past year, with an increasing number of devastating climate events witnessed globally. As a member of the Institutional Investors Group on Climate Change (IIGCC) we signed a letter calling upon the leaders of the European Union to ensure that infrastructure investment in the wake of the COVID-19 pandemic is focused on clean energy, carbon capture, and other green technologies.

The need for clean energy is marked and the European Union's recent Sustainable Finance Disclosure Regulation (SFDR) requires further transparency and reporting from market players on sustainability. As a leading clean energy investor in Europe we believe it is critical to have an active role in helping to advance the important objectives of the SFDR. Our goal in electing Article 9 designations – the most competitive disclosure and reporting requirements – for several of our clean energy infrastructure funds is to help encourage others to support compliance and reporting on the SFDR in the private assets industry.

As awareness of the risks associated with climate change grows, we expect investors to look more closely at ESG policies and how frameworks are implemented across portfolios and through the entire lifecycles of our projects. A number of new ESG players may enter the market promoting new ESG compliant funds, but it is believed there is a significant first-mover advantage for those firms who have been longstanding proponents of good ESG practice and have a deep understanding of how to make a real difference here.

Conclusion

The outlook for renewable energy infrastructure is bright. For long-term, specialised renewables investors, this is a pivotal period where value can be prudently extracted for investors while building a greener, more sustainable future. The last five years have been exciting, but with support mounting from governments, corporates, utilities and private markets, interest in renewables will continue to accelerate.

About Capital Dynamics

Capital Dynamics is an independent global asset management firm focusing on private assets, including private equity, private credit, and clean energy infrastructure. For more information, please visit: www.capdyn.com

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