

# Financing the energy transition

Energy security and climate change are driving an unparalleled economic shift in the energy sector worldwide, and reshaping the investment landscape for green energy credit.



Claudio Vescovo, Head of European Energy Transition Credit Funds at Nuveen Infrastructure explains how the current market dynamics (including the recent banking crisis) are providing investment opportunities for green credit.

**In the first half of 2023, we have seen Silicon Valley Bank, First Republic Bank and Signature Bank in the U.S. along with Credit Suisse in Europe failing, and swift action from regulators to prevent potential global contagion. What impact will the banking crisis have on green energy credit?**

In short, the banking crisis will present opportunities for credit investors. It is becoming more expensive for certain banks to keep long-term project financing on their books, and others might decrease their overall allocation to new lending, creating opportunities for alternative sources of lending, as it did following the global financial crisis.

Opportunities can be found through direct lending to green energy projects, whether through junior or senior loans, or purchasing loans directly from lenders to relieve some of the stress on the balance sheets, or other methods that alleviate charges to banks and other lenders. These tools have been used for decades in many sectors, but only few fund managers have applied them to the green infrastructure sector.

**How dependent is the investment thesis for green energy credit on the current bank situation? What's the long-term thesis for the asset class?**

The energy transition is here to stay and the funding needs will only increase in the coming years. In Europe alone there is a need for €5 trillion in investment to finance the energy transition between now and 2030, according to the G20. Over the last 10 years, the cost to generate renewable energy has come down significantly and it is now cost competitive vis-a-vis conventional sources in many European countries. In addition, the war in Ukraine has underscored the need for energy security globally. New clean energy investment will be critical to address both energy security concerns and climate change.

**What is the opportunity set for investors in green credit?**

Traditional financing is available and there are ample opportunities for credit investment, however there is a large funding gap for lenders who can provide innovative and tailored solutions to borrowers. Our strategy will benefit from this extensive and long-lasting opportunity set.

**What benefits can green energy credit offer investors?**

Green energy credit can offer much needed diversification. We've seen in the last 12 months how market volatility can impact portfolios that rely heavily on equities and corporate lending. Investments that are not publicly traded have the potential to offer a ballast to underperforming asset classes thanks to near-uncorrelated returns. Steady income flows combined with a low correlation to traditional asset classes can benefit investors looking to build a well-diversified portfolio.

Lending to clean energy projects means bearing very little-to-no market risk, as borrower's cashflow generation is normally sheltered from market prices through

incentive schemes or long term power purchase agreements. Thanks to such offtake agreements, the borrower cash flows become predictable and the duration of the loans tends to fall within the length of such fixed-priced contracts. This is different from corporate lending, where businesses can be exposed to price risk, volume risk, and marketing and management risk, just to name a few.

**“In Europe alone there is a need for €5 trillion in investment to finance the energy transition between now and 2030, according to the G20.”**

**With senior and mezzanine loans now appearing in energy transition infrastructure, what impact will they have as the sector matures?**

Having various entry points to the capital stack of debt investment offers further diversification within the asset class. With junior, senior and super senior placements available, investors have a wide risk/reward profile to choose from.

These loans demonstrate the appetite from both lenders and borrowers to tap into the growth seen in the sector.

Green energy credit has seen consistent growth patterns of investment flow across the last two decades, demonstrating a resilience across economic crises like the global financial crisis and the European sovereign debt crisis that followed.

With policy being introduced to support clean infrastructure projects, the influx of senior and mezzanine loans offer further ways to finance these projects.

**What risks should investors consider?**

Of course, as with any investment, there is a risk of capital loss or

defaults. According to Moody's, the probability of default of project finance loans to infrastructure globally is below 1%, with a recovery rate above 78%. In contrast to corporate loans, default rates on infrastructure loans decrease overtime; this is because assets become operational and prove their operational efficiency, causing risk to tail off.

This feature can be very attractive for medium and long term investors.

**How can investors overcome these challenges?**

As mentioned, addressing the risks involved with clean infrastructure debt can be complex, and new investors may well benefit from partnering with an experienced asset manager. A skilled partner will be able to guide investors through the risk-return profile of loan structures to help identify the most appropriate investment for their needs.

Such a partner can also provide a comprehensive due diligence process. For example, our investment process for infrastructure credit is based upon a proprietary rating tool that we have built and developed in-house. We have not found a rating tool in the market which is completely fit for purpose and is tailor-made specifically for energy transition lending. Our capabilities are rooted in 20 years of experience as a firm in clean energy investments. Every loan is assessed through our rating tool and we invest only in those credits that pass this test.

Claudio Vescovo speaks about the opportunities within green energy credit more in our research note 'Why Green Energy Credit Now'



**nuveen**  
INFRASTRUCTURE