Why choose semi-liquid funds for investing in renewable infrastructure?

There are more opportunities for investors to access renewable energy investments today. We look at how semi-liquid funds fit the bill.

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By 2030, over $2 trillion is expected to be invested in the infrastructure supporting the energy transition annually[1]. A large proportion of this capital will be required into traditional renewable energy assets like wind farms, solar power plants and hydro-electric plants, but capital is also being invested into areas such as green hydrogen production, battery storage and large-scale heat networks.

We have previously explored how this asset class appeals to investors for both economic and sustainability reasons. While the sustainability outcomes are undeniable, the economic benefits to a portfolio are arguably the reason why this is fast becoming such an integral part of wealth investors' portfolios; the energy transition offers investors exposure to diversifying risks and strong returns driven by high, stable, and predictable cash flows.

What is a semi-liquid fund?

Semi-liquid funds have been created to make it easier for investors to access, allocate and manage illiquid assets exposures. Traditional illiquid fund structures have always had significant barriers to access for some investors due to the high minimums, capital call drawdown structures, and long lock ups.

Within semi-liquid structures, investors can buy and sell at a prevailing Net Asset Value (NAV), with entry and exit points (and rules around those points) that have been developed to provide liquidity in a controlled manner, typically with a cap on how much can be redeemed at any given time, often 5% of NAV. A well-constructed portfolio, diversified by geography, sector, and asset type (and with a potential small allocation to liquid investments, such as listed equity and cash), can engineer a level of "natural liquidity" that is regular and consistent. Semi-liquid funds also employ liquidity management tools that can control liquidity within the fund, such as setting redemption limits and realising liquid investments.

Why does a semi-liquid fund make sense for the energy transition?

Investing into illiquid assets is new to many investors, and the semi-liquid structure has been designed to answer the key questions that investors targeting the energy transition might have.

1. **Immediate access:** Ultimately, the major benefit of semi-liquid structures is the ability to access high quality and differentiating assets that are easy to operate. In the case of energy transition infrastructure, investors can benefit from its risk and return characteristics, which can contribute to better portfolio outcomes, and access the attractive entry point on offer in the market today.

2. **Flexibility:** The energy transition is a long-term theme, and investors in this space generally have a long-term mindset. However, we recognise portfolios and allocations change over time. While renewable infrastructure investments are typically considered illiquid, semi-liquid funds strike a balance by providing regular access to liquidity. Investors can manage their exposure up and down with the flexibility of periodic subscriptions and redemptions at the fund's NAV.
   It's important to highlight that even if semi-liquid funds offer periodical redemptions, these are still exposing to illiquid investments. Redemptions are managed through a combination of factors; the high level of cashflow delivered by energy transition assets, a modest holding of liquid assets and, if needed, the ability of the fund manager to sell stakes in energy transition assets to the large and growing marketplace of buyers and sellers.

3. **Evergreen:** The "evergreen" open-ended structure of semi-liquid funds enables continuous investment in the fund, allowing investors to see their money put to work immediately. Their subscriptions are added to the existing pool of assets and used to purchase more assets to broaden the overall pool. This method enables the existing investors to benefit from potential growth and returns from the purchasing new assets in the portfolio, while allowing newer investors to get access to a diversified portfolio from the first day of their investment.

4. **Costs:** Fee structures vary among semi-liquid funds, but due to increased regulatory scrutiny and the emphasis on transparency, fee information needs to be extra clear.
   Within a semi-liquid structure, investors are generally given a full look-through to all the fees paid to the manager, and so elements like a transaction fee (where a manager is paid an additional fee for buying or selling assets) are visible. Similarly, some managers charge performance fees over and above the fees already mentioned, and in semi-liquids these need to be disclosed.

Overall, investors who consider an investment in the energy transition need to understand that to maximise the benefits, it is crucial to view these as long-term investments. Therefore, allocations should be considered in the context of the portfolios objectives, liquidity needs and risk tolerances. This is aligned with the nature of renewable infrastructure assets which typically have long economic lives.

Investors should be aware that holding liquid assets (cash and listed securities) means this is not a 'pure' energy transition exposure. And while the semi-liquid structure does enhance the liquidity options available to investors, there are limits to what can be delivered. Having a controlled limit on redemptions does introduce the risk of gating within these structures, and ultimately in truly difficult markets there is the potential need to further limit redemptions to protect investors. Both should be considered by investors when sizing semi liquid positions within their broader portfolio.

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[1] IRENA

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