

Renewables investment

CHRISTOPHER
CLEMENT-DAVIES, JEFF
BLOUNT, GIRARD MILLER,
ANN-MARIE EVANS AND
PHILIP WOODRUFF*

Fulbright & Jaworski International

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Barriers to investment

Investment in renewables is forecast to continue its recent, rapid growth, but there are a number of obstacles preventing it reaching its full potential, especially in emerging markets. This article examines these impediments and how they might be overcome.

Recent years have, of course, seen dramatic growth in investment in the renewable energy sector. Some \$150 billion of new money was attracted to the sector globally in 2007, a 60 per cent increase compared to 2006, outstripping projected levels, with investment levels estimated to reach \$450 billion and \$600 billion by 2012 and 2020 respectively.¹ Many governments around the world have been introducing legislative and policy frameworks designed to encourage the use and development of renewable energy. The volatile oil price since the late 1990s, and the urgency with which climate change issues are now being debated at so many levels, have only served to reinforce and accelerate the drive to renewables.

However, this growth is not without its impediments. Unsurprisingly, the renewables sector has been as susceptible as others to the impact of the credit crunch, with public market financing for sustainable energy virtually drying up in the first quarter of 2008, though this did seem to rally a little in Q2. The WilderHill New Energy Global Innovation Index,² for

example, saw a (17.9 per cent) drop in its value, whilst venture capital/private equity in this area was down by approximately 32 per cent from Q1 2007. Leaving aside the short-term impact of the financial crisis, however, it is worth asking whether there are other systemic weaknesses that are preventing the tide of new money in this sector, so to speak, from becoming a torrent. This article looks at a few of the obstacles that stand in the way of still greater levels of investment in renewable energy projects, with a particular focus on emerging markets. It is important to recognise and address barriers of this kind if the enormous potential of renewable energy is to be more fully realised. The particular barriers discussed here have been broadly split into two categories: economic/financial and political/legal ones.

Economic and financial

Investment in renewable energy projects in emerging markets is widely perceived as exceptionally high risk, for many reasons. First of all, the generic risks associated with renewable energy projects, including technology risk, operating risk, commercial/market risk and natural/force majeure risk, are compounded when they are coupled with the wider (and well-understood) challenges of doing business in many developing economies—including concerns about the sophistication of the legal system, the enforceability of contracts, the independence and reliability of local courts, uncertainties about the viability of certain financing and security structures and their enforcement, and so on—add additional tiers of risk that can easily disincentivise investors. It is important for the viability of long-term energy projects that political, economic and regulatory conditions in a given country and jurisdiction remain stable for the life of the project and that governments and utilities adhere to their legal and contractual obligations. Investors also have to factor in the relatively unpredictable rates of return often encountered in under-developed and poorly understood markets. These may be heightened by foreign exchange risk, where the currency used to finance the project differs from that received from the project's revenue streams.

Then there is the problem of scale. Most renewable energy projects in emerging markets tend to be comparatively small, but can involve relatively high initial capital cost per kW of installed capacity (for example) or unit of energy produced. Transaction costs will often be relatively high, particularly where project finance is used. This can raise concerns about financial viability and adequate returns. One possible solution is to bundle together a number of small, comparable projects, allowing investors to treat them as a single transaction. For example, C Trade, a renewable energy firm based in India, helps finance bundled biogas projects, via carbon credits.

Accurate costing, including cost comparisons with fossil fuel alternatives, can represent a further challenge. Despite the higher initial cost of capital

* Christopher Clement-Davies (cclement-davies@fulbright.com) is a partner in the international project development and energy team in the London office; Jeffrey Blount (jblount@fulbright.com) is partner in charge for Hong Kong and Beijing; and Girard Miller (girard.miller@fulbright.com) is a partner in the Minneapolis office and is co-chair of the firm's global alternative energy practice group. This article was written with the help of Fulbright associates Ann-Marie Evans and Philip Woodruff in London, and Sandy Li and Chris Lau in Hong Kong.

1 United Nations Environment Programme and New Energy Finance Ltd, "Global Trends in Sustainable Energy Investment 2008".

2 The WilderHill New Energy Global Innovation Index is a share index which comprises companies focused on the generation and use of cleaner energy, conservation and efficiency, and advancing renewable energy generally.