Q&A

Plunging costs, burgeoning opportunity

John Breckenridge, Capital Dynamics' head of clean energy and infrastructure investment management, talks about the clean energy opportunity in Europe and the US and why its drivers are not going away

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Q Where do you see the best opportunities in the clean energy market at the moment, and what is creating these opportunities?

JB: There are three areas that look particularly interesting at the moment: the first two are renewables and natural gas in the US, due to the continuing coal-to-gas transformation, which will be going on for several years; the third thing is existing, and some greenfield, renewables in Europe, with fragmented ownership and opportunities to acquire assets that are very high quality with low risks.

What is driving these opportunities is the decrease in the cost for wind and solar, along with broad continued concern about environmental issues globally. That's number one. Number two is the long-term sustained lower levels of global natural gas prices that are reducing conventional power prices across the world [and] which continue to drive coal-fired power out of the market.

Q The original team that launched Capital Dynamics' clean energy business has now departed. How has the business grown since you took charge in 2015?

JB: The original team really created a great foundation for this business, for which I'm very appreciative. We've taken it to another level now and it's very exciting to be where we are, with the team we have across Europe and the US.

Currently, our assets under management are about $2.1 billion and when the original team left it was under $1 billion. So we've seen a tremendous amount of continued growth over the last couple of years and continued support from both our existing investors – many of whom have invested in us repeatedly – and also a number of new investors we've brought on.

Q What's been driving this growth?

JB: I think we have benefited from a trend among investors toward assets that are lower risk and held long term so that they don't trade repeatedly throughout their life.

The second thing is that, since I've joined, we've really strengthened our capabilities in the US market and now have approximately 700MW of solar either operating or in late-stage construction; 450MW of wind; and two combined-cycle plants, all in the US.

Q What are you hearing about clean energy from the LP community?

JB: There's a tremendous amount of interest in renewables from all types of investors, partly because the sector provides long-term contracts. However, these assets also tend to come with a slightly lower return level. So you have some investors who are unable to invest in that because the return levels are lower than their thresholds.

Gas plants tend to have some additional risk to them, so the returns tend to be a little higher than renewables.

They generally take a significant amount of capital, so they're also more suitable for larger investors.

Q What is behind this interest in renewables? Has the COP21 Paris agreement helped drum up support, or was the market moving in this direction no matter what?

JB: There has been very little impact to date from the Paris agreement in the renewables sector. The primary federal incentives for renewables in the US are from the investment tax credit and the production tax credit. These were in place before the Paris agreement. In Europe, there has been a tremendous amount of societal support for renewables. That was there prior to the agreement and continues to be there now.

As I mentioned before, the biggest driver for the success of renewables over the last couple of years has been the significant drop in cost for both wind and solar. When you have the kind of precipitous drops in costs that we've seen in both of these technologies, as with the drop in gas prices, for example, those economic drivers tend to have a much bigger impact than any type of policy. This will be more and more true as renewables mature and grow as a part of the generating fleet.

Q Speaking of policy issues, there were a couple of big ones in 2016. Let's start with Brexit. What do you think the long-term impact of Brexit will be on the clean energy industry?

JB: It's hard to know what the long-term impact of Brexit will be for our industry. In the short term, there have been two impacts on the clean energy industry. The first impact has been the change in the US dollar-pound exchange rate. That basically means that existing assets in the UK are worth less in dollar terms and new assets in the UK are cheaper in dollar terms.

The second impact is it has arguably led to slightly higher power prices in the UK, which generally benefits existing projects. So far, there has not been a significant impact because those two things tend to balance one another out. Obviously, it's not clear in the long term how this will all go, and so we'll have to see.

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Q What about the US election? Will President Trump's favoring of the fossil fuel industry have a negative effect on renewables?

JB: That's probably the question that I get asked the most by investors these days. Going back to what I said earlier, federal support for renewables comes from the investment tax credit and the production tax credit. There is a strong feeling among most members of the industry, based on comments from members of Congress from both parties, that the existing agreement for the five-year phase out of the investment tax credit and the production tax credit is going to remain in effect.

With tax credits still in effect and no real change in state support for renewables, along with the continued drop in cost, Trump's election is not having a significant impact on the renewable sector in any way we can see so far.

Q How will the phase out of investment and production tax credits affect your strategy?

JB: History would show that people who try to prognosticate what's going to happen in the power industry in five years have been very wrong in most cases. So I'm not going to do that. What I will say, though, is that there is a general expectation that a combination of reduced costs and a little bit of additional support in terms of power pricing will ultimately replace the investment tax credit and the production tax credit. If that happens, the incentives have done what they were supposed to do. They enabled an industry to get started. They enabled it to drive down the cost curve. And they enabled it to compete on its own.

Q What excites you most about the clean energy industry going forward?

JB: I continue to believe that the next several years are an opportunity to invest in greenfield renewable energy projects in North America. There has been an opportunity created by the departure or the pullback from yieldcos. In the gas space, there continue to be a significant number of opportunities in North America.

As a long-term hold investor, we also see a lot of potential in European greenfield, but there are many existing operating projects too. As you go into Spain and Italy, you have markets that have scared off a number of investors because of changes to tariffs in the past. However, that's also created interesting opportunities. There are attractive projects in the Nordics, as well as in Germany and France. In the UK, you have projects that continue to benefit from some of the existing tariff regimes – both new and existing projects. ■