SuperReturn 365

The rise in LP demand for clean energy investments

What is the appetite for clean energy investments, and what opportunities are limited partners (LPs) more likely to be interested in? Scott Brown, CEO and Managing Partner at New Energy Capital, discusses the current state of the renewables sector in private equity in North America in an exclusive Q&A with SuperReturn.

How have attitudes among LPs towards investing in the energy sector changed over recent years?

What we are seeing is an increasing number of LPs, who have generally been heavily weighted towards fossil fuels in the past, are now interested in diversifying their portfolios to embrace renewables and clean energy. There are two main motivating factors for this: some LPs are motivated by environmental concerns and are looking to introduce more of an ESG factor-based approach to their investing. Others are motivated by the long-term risk of demand destruction associated with the electrification of the transport industry, the potential for carbon pricing, and increasing consumer demand.

In our view, LPs are realizing that the traditional power and fuels markets are flat or declining, while the renewable power markets are consistently growing. These dynamics are attracting LPs who are diversifying their energy portfolios and shifting more of their allocations to the renewables sector.

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Each LP is different. Foundations and family offices tend to be more focused on the environmental aspects, while insurance companies and traditional energy investors are primarily focused on the shift in demand towards renewable generation. Some have both concerns in mind.

What do you see as the opportunities for investing in clean energy/renewables?

We are expecting long-term growth in the clean energy power markets. By long-term, we mean over the next 20 years. In the US – which is New Energy Capital's primary area of focus – we are still in the very early stages in the transformation of the electricity generation sector.

It is at a much earlier stage than in Europe – wind energy accounted for less than 7% of all US generation in 2017 and solar accounted for less than 2%. This compares to around 11% and 4% respectively across Europe, with much higher numbers in Germany, the UK and Scandinavia. There is still enormous market opportunity for penetrating the generation markets in the US.

How have recent policy changes towards clean energy by the current administration in the US affected the investment case?

Policy changes at the federal level have had very little impact on the market in the two years since the new administration took office, and renewable generation has continued to grow. This growth is being driven by two primary factors. The first is a fundamental reduction in the cost of clean energy technology, while the second is the replacement of uneconomical and ageing existing infrastructure.

More than 50% of US generating capacity is over 30 years old and no utility is expected to build another coal or nuclear power plant in the US in the foreseeable future. Utilities expect to replace old infrastructure with a combination of renewables and flexible gas-fired generation. That is a really new development over the last couple of years. Prior to a year or so ago, utilities were reluctantly adopting renewables under pressure from the state regulators. Now they are aggressively embracing and adopting renewables in their integrated resource plans.

How do you think the clean energy sector will develop in the medium and longer term?

Over the next three to five years, we expect a very consistent growth. The tax regime is stable and predictable over that period. Beyond that it is a little bit difficult to say, as investment tax structures in the US market will have sunset by then. There is some expectation that these will be renewed by Congress but there is considerable expectation that technology costs will have declined enough to offset the tax incentives by then anyway.

Private equity currently accounts for a small fraction of overall investment in clean energy. Is this something you see changing? Do private markets have a bigger role to play in the development of clean energy?

Private equity, in our view, is the most nimble form of capital. It flows quickly to new opportunities when these opportunities become apparent. We believe that private capital will comprise a significant share of all the investment dollars coming into the sector over the next five years as investors recognize the enormous capital requirements associated with the transformation of the utility industry. Some of this capital will be driven by an increasing focus on impact investing, which is a sector we think is just emerging as a significant driver of private capital. It's been a relatively small share over the last two to three years but that share is growing quickly.

Our LPs are very enthusiastic about the sector and we expect to see continued growth over the next two to three years. We have opportunities in front of our current investment committees that we expect to continue to grow over the coming years.

Under the spotlight: Scott Brown

Scott Brown is the founder and CEO of New Energy Capital Partners. Founded in 2004, New Energy Capital is a leading investor in clean energy projects in the United States with over $600 million in assets currently under management. Mr. Brown was a member of the founding management team of First Solar, and was a member of the National Advisory Council of the National Renewable Energy Laboratory from 1999-2005.

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