SPECIAL REPORT

HOW TO IMPROVE INVESTOR CONFIDENCE IN EMERGING WIND MARKETS

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A WORD ABOUT WIND

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Contents

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Seamus McCabe, Vice President, Green Investment Group

Tatiana Preta, Managing Director, Project Finance, Global Corporate & Investment Banking, MUFG

Javier Chavarria, Managing Director and Head of Latin America, Northland Power

Andy Evans, CEO and Co-founder, Oceanex Energy

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Summary

The energy transition is being held up by a lack of investable projects in emerging markets.

Whether it is an inability on the part of governments in some markets to run large-scale tenders, consent projects expediently or a lack of political support for such moves, getting projects off the ground can be extremely challenging.

Other obstacles blocking the development of projects in some emerging markets include difficulties connecting to the grid due to long distances between renewable energy sources and load centers.

Meanwhile, developing local supply chains for projects can also be challenging. However, as a result, funds have identified supply chains as a significant investment opportunity due to the fact that emerging markets often lack vital manufacturing facilities.

This report will address these issues in more depth while also identifying the steps that should be taken to address these problems with a view to kick-starting proposed projects that may be struggling to gain traction.

Investable projects in short supply

While investor confidence in renewables in emerging markets is high, there is, generally speaking, a shortage of investable projects.

So, what factors are holding up investment in emerging markets?

Lisa Pinsley, director and head of Africa energy infrastructure at Actis says the first thing to note is that, among certain groups investor confidence is "high". She adds: "We see a significant amount of competition across emerging markets, even in Africa, in the renewables space, and sometimes I feel people are underpricing the actual risk. There is some crowding of the private sector on both the equity and debt sides with multilateral money. Despite the popularity of the sector, it is still key to have teams on the ground in the markets to drive these projects from bid award into construction."

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However, Pinsley points out that there is often a lack of investable projects and this is usually due to a number of factors. "In Africa, the energy sectors generally aren't unbundled and therefore government-owned utilities have to do the planning for the procurement rounds – this requires a significant amount of preparatory work across utilities and ministries, as well as top-down political support, which can result in fewer procurement rounds."

Another major constraint in energy investment relates to the grid, according to Pinsley. She says that it is often the case that locations where wind and solar resources, for example, are most plentiful are often hundreds of kilometers from a load center. "The grid in most cases is still a government-owned asset, which means only public sector financing can go into it and that can take a decade. Allowing the private sector the opportunity to invest in transmission would be transformational in opening more renewables investment opportunities," Pinsley says.

You must proactively engage with governments

If you want scale, offshore wind is a good pathway to doing that because it can deliver sizable projects relatively quickly

It's important that developers seeking to take advantage of opportunities in emerging markets engage in a proactive manner with the respective governments, says Séamus McCabe, vice president, Green Investment Group.

Such engagement is necessary to facilitate the pathway to development and delivery, he adds. "If you want scale, offshore wind is a good pathway to doing that because it can deliver sizable projects relatively quickly, although it is very much a ten-year journey from initiation to delivery." McCabe says.

He adds that it is important that these pathways are explained to individual governments to ensure the permitting and consenting journey can be delivered smoothly and to "find the doors to open for the capital to be deployed".

Andy Evans, CEO and co-founder of Oceanex Energy, says that, in the case of Australia, there is a very conservative outlook when it comes to renewable energy and there is strong belief that wind technology needs to be tested before putting it into operation. The grid is another major issue: "We have abundant resources, but a backward grid infrastructure – in many ways Australia has rested on its laurels a bit too much and we're now competing with the Philippines, Thailand and Vietnam, for example."

Evans adds that the challenge for Australia is to get regulators "moving quickly", though he acknowledges that, in recent months, a bill was introduced that aims to establish a framework for offshore electricity projects. Evans continues: "The challenge for us is to get investors, developers and operators to come to Australia and invest in our projects."

Challenges in Latin America

Offshore wind will not be a realistic opportunity in Latin America for some considerable time, according to Javier Chavarria, managing director and head of Latin America at Northland Power. "There are no government incentives, no subsidies that would make offshore wind competitive enough with all the other sources of generation," he says.

The grid is another major challenge in Latin America, according to Chavarria. "Normally you can find alternatives where you would locate your projects at reasonable distances from existing transmission lines – so if you add the cost of connecting an offshore facility, you're putting a bit more of a burden on the offshore side," he says.

Tatiana Preta, managing director, project finance, global corporate and investment banking at MUFG, echoes the view that Latin America is not an attractive market for wind investors at present due to the general lack of solid regulatory frameworks.

Preta adds that returns on investment are often very low and the markets can be very competitive meaning it is "difficult to introduce offshore wind". Preta says that in Peru, for example, political instability is preventing the development of projects, while in Mexico there are regulatory issues with "government measures that would interfere with the renewables sector".

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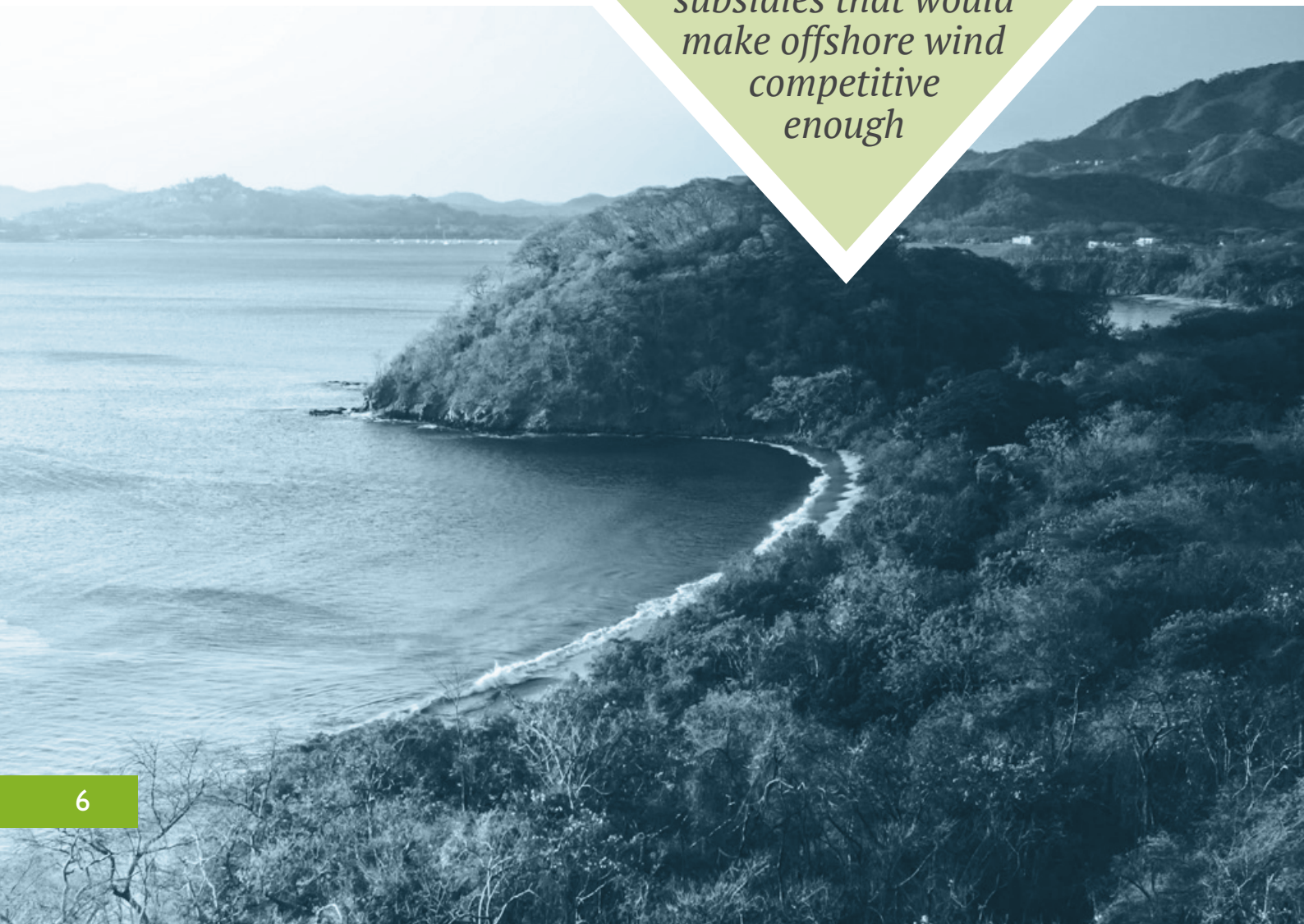


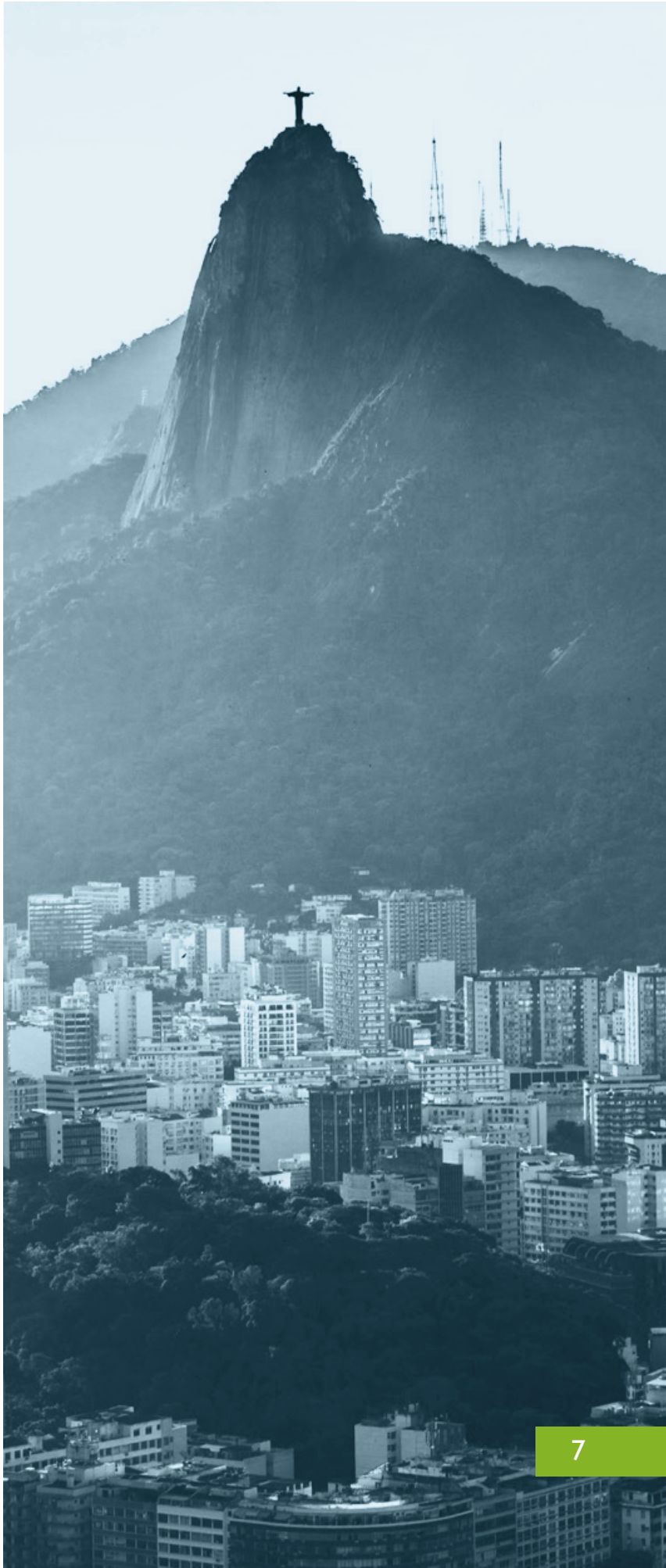
Establishing supply chains

Project sponsors are increasingly focused on hybrid projects – wind with PV and/or including storage, for example – as they attempt to remain competitive, says Cristian Algar, director, renewables Europe and Latin America at UL. However, he adds that emerging markets are challenging in the context of having a suitable local supply chain, and that, in some emerging markets, it will take a number of years to develop it.

With regard to the Australian market, Evans points out that, given that Australia is a significant distance from other parts of the world, getting components to the country using vessels is an enormous challenge. He adds that Australia's diminishing manufacturing sector is another problem the wind industry faces. "Getting meetings to even get on the order books is a challenge at the moment," Evans says.

In Latin American, Brazil is one of the countries with one of the most advanced local supply chains, according to Chavarria, but he adds that other countries in the region are at the beginning of the learning curve, though he says that in a number of years, the solution in those countries will be "figured out".

Local supply chain considerations are very important when investors are making decisions about financing projects, says Preta. "We really dig deep to understand who is your contractor and supplier and who is actually going to be working on site," she adds. Preta says that, in the context of Brazil, MUFG can't compete with local subsidized financing by development banks: "It's a tough market for an international bank."



Need to grow larger, more predictable, demand

Pinsely says that, in the context of Africa, to stimulate the wind manufacturing sector, there needs to be much larger demand and more predictable demand. She adds that South Africa made some good progress, but then momentum was lost because there were "five years between the round four and five [auctions]".

Pinsely says that, in other parts of Africa, a more practical approach has been adopted and there is an expectation that local capital is used, but that is also problematic because, for example, PPAs are "denominated in US dollars so local banks can't participate in the financing". However, she adds that there are often local pension funds that have the necessary capital.

From the perspective of attracting capital and investment, medium-term visibility and confidence in market scale is essential if local or regional supply chains are to emerge – which is also true from a capital raising perspective according to Rael McNally, director, global renewable power and lead portfolio manager for BlackRock's inaugural emerging markets fund the Climate Finance Partnership. "Proving out the robust growth and fundamental need in these [emerging] markets is key". He adds that while emerging markets are starting from a low base, "if you look longer-term, over 20, 30 years, the opportunity is pretty enormous".

McNally says that there are lots of challenges for investors and limited partners, including their own regulatory considerations around capital treatment issues for investing in emerging markets compared to OECD countries. McNally continues: "If you're an insurer or a pension fund, the capital treatment of non-OECD investment is pretty tough as regulations don't necessarily distinguish between lower risk, low default and high recovery asset classes like infrastructure." He goes on to say that "generally, as an asset class, infrastructure is largely privately held meaning there's not a lot of public data out there that people can use to run their desktop analysis, run their models internally and develop a risk framework".

Supply chains are 'investment opportunity'

Supply chain and skills investment opportunities in emerging markets are becoming more and more tangible, according to McCabe. "I think there are investment opportunities in the supply chain – there is so much growth potential in emerging markets, the scale isn't there to deliver the projects and investment in manufacturing facilities is needed," he says.

To justify investment in establishing a local or regional supply chain, investors need clarity about how big the emerging market opportunity in question is going to be and when it will reach that scale, says McNally. "If investors don't have that clarity, it's going to be hard for them to mobilize behind it," he adds.

I think there's a lot we can do in providing training and upskilling local labor in order to build local capability for EPCs

McNally says that, while requiring local content has been successful in the past, he does not think it will be effective in the future. "I think global supply chains are complicated and getting more so. Most individual markets don't and can't offer the kind of scale necessary to objectively justify establishing a local supply chains in isolation, so you may need some regional cross-border participation to get to scale." He continues: "That said, if we think about aspects beyond the equipment supply chain specifically, I think there's a lot we can do in providing training and upskilling local labor in order to build local capability for EPCs [engineering, procurement and construction] and to get them to the highest international standards from a technical perspective. That has real long term value as an investor".

Another issue in emerging markets is that often grid infrastructure is lagging behind the pace of deployment of renewable energy projects, says Chakradhar Byreddy, director, Renewables-Asia Pacific, UL. "There is a mad rush of auctions coming out that is outpacing the grid infrastructure and that is what's causing a lot of bottlenecks, which is also creating pressure on the supply chain." Byreddy adds that another issue is the extent to which energy storage can come into play and help existing assets that are not performing well.

'Choose your narrative'

In Australia, there is a disjointed regulatory framework with power over seabed rights held by the commonwealth government, while "everything electricity and connection-based is state-based", Evans explains. The solution, according to Evans, is to "choose a narrative" for your project very early. "We picked jobs and investment and regional development rather than saving the planet and decarbonizing, we had to try and take the politics out of it to deal with the politicians."

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Preta says there are different ways of dealing with regulatory issues. "We see players getting together and pushing for that [regulatory change], we get asked to comment on the bankability aspect of certain regulatory changes to get to the government to listen to the banks in terms of potential changes that could create issues from a financing perspective, so there's much more of an open dialogue."

The Asian market represents a significant opportunity for offshore wind, according to McCabe. "Building on the success we've had in Taiwan, we're now in the Korean market, though it's clearly a first world economy, but there are emerging markets on their doorstep, Vietnam for example, where we're looking at developing offshore projects." He adds that, while there are regulatory risks such as permitting for offshore wind, for example, that is also "the journey onshore wind and solar has gone on, so there's always a certain amount of risk".

From a technical point of view, all issues can be solved, according to Algar. "It's a matter of how much capex will influence your project and obviously that's going to affect your rate of return, but from a technical point of view everything is doable – the main concern relates to new technologies and whether those new technologies are suitable in an emerging market."

Algar adds: "We are seeing OEMs putting in place turbines that are just certified on a piece of paper and have not been proven but it's the way the sponsors are able to be more competitive in those markets." Algar says there is huge demand for the hybridization of renewables projects, and that there will be a move away from standalone projects to projects linked with storage.

Conclusion

Getting wind projects up and running in emerging markets can be extremely challenging.

Despite substantial investor appetite for such projects, issues such as a lack of political support, confusion around local permitting requirements and a lack of momentum due to delayed auctions can prove to be substantial obstacles to progress.

Similarly, underdeveloped grid infrastructure and supply chains are also common problems that are impeding the energy transition in emerging markets.

However, there are steps that can be taken to increase the chances of proposed developments gaining traction.

To begin with, it pays to choose an effective 'narrative' for your project when seeking to win political support. Depending on the political persuasion of the government in question, it may be advantageous to emphasize the job creation and economic development aspects of your project, rather than focusing on decarbonization or climate change.

In addition, it could be beneficial to get financial institutions involved to advise on the 'bankability' of projects.

Wind energy investors also say that there are opportunities to strengthen local supply chains by investing in upskilling and training to bring engineering, procurement and construction up to international standards.

There are indeed grounds for optimism, and if the aforementioned steps are taken, we can have every confidence that there will be enormous opportunities for the wind industry in emerging markets for decades to come.

If you'd like to find out more about our Wind Investment Boardroom programme **click here** or get in touch with the team:

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