ROUNDTABLE

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Leaders of the green world

A year on from the Inflation Reduction Act, the US is rapidly positioning itself to overtake Europe as the global energy transition frontrunner, our roundtable participants tell Amy Carroll

The Inflation Reduction Act signed into law just over a year ago is already having a profound impact on the US infrastructure industry. Crucially, it has provided clarity on the market for renewable generation and thereby significantly enhanced the opportunity set.

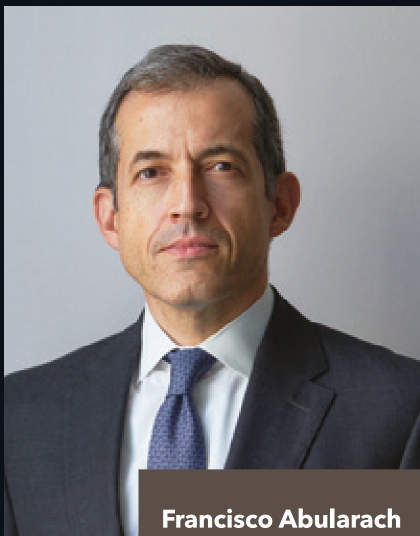
"That certainty around the continued support for clean energy is something that has been lacking in the US for a long time," says David Whitcher, managing director at I Squared Capital. "We are certainly seeing an increased volume of opportunities requiring capital as a result of the IRA."

In addition to traditional renewables, the IRA has provided a powerful stimulus for emerging energy transition technologies. "For our industry, a major opportunity has opened up with respect to hard-to-abate industries, like carbon capture and green hydrogen," says Andrew Pike, partner and co-head of Ares Infrastructure Opportunities. "The incentive regime that has been created has allowed our industrial partners to refocus talent and capital on an opportunity set that was largely ignored or cost-prohibitive before this legislation was enacted."

The IRA has strengthened the opportunity set in traditional renewables, with solar being a notable beneficiary, adds Francisco Abularach, senior partner at Antin Infrastructure Partners. "But there is no doubt that this legislation has also had an impact on emerging technologies. We would argue that technologies such as hydrogen and carbon capture are not yet sufficiently developed commercially to be ready for our flagship infrastructure fund. But

David Whitcher
Managing director, I Squared Capital

David Whitcher is a managing director at I Squared Capital focused on energy transition. I Squared Capital is an independent global infrastructure manager with more than $37 billion in assets under management across North America, Europe, Asia and Latin America.



Francisco Abularach
Senior partner, Antin Infrastructure Partners

Francisco Abularach joined Antin in 2021 and is a member of the firm's investment committee. He previously spent more than 25 years at Citigroup, where he spearheaded the establishment of the bank's infrastructure practice.

Bruce Chapman
Partner and co-founder, Threadmark

Bruce Chapman is partner and co-founder of placement agent Threadmark. He has led the firm's infrastructure business since its founding in 2009 and has 22 years' experience of capital raising.

Andrew Pike
Partner and co-head, Ares Infrastructure Opportunities, Ares Management

Andrew Pike serves on the Ares Infrastructure Opportunities investment committee. Prior to joining Ares in 2015, he was a partner at Energy Investors Funds.

our Next Generation Infrastructure fund, which is a separate pool of capital that looks for opportunities in technologies that have not yet been commercialised at scale, is also seeing greater opportunities as a result of the support that the IRA has given."

This proliferation in dealflow has inevitably been met by a significant increase in the number of funds being raised to target the space. The energy transition ecosystem has also become more nuanced.

"Wind the clock back a few years, and energy transition usually meant asset managers targeting wind and solar," says Bruce Chapman, founder of infrastructure capital-raising boutique Threadmark. "Fast forward to today, and we are seeing a huge variety of players and strategies, including conventional energy managers shifting wholesale into energy transition and new entrants that might previously have been developers or operators.

"We also have specialists looking to raise funds around specific themes such as hydrogen. All that noise creates a degree of confusion in the market, but it creates a lot of opportunity as well."

> *"There is no doubt that [the IRA] has also had an impact on emerging technologies"*
>
> **FRANCISCO ABULARACH**
> **Antin Infrastructure Partners**

Regime change risk

Meanwhile, despite looming presidential elections, market participants appear unconcerned that a regime change could lead to aspects of the IRA being watered down or reversed.

"The IRA has something for everyone," says Whitcher. "It is full of carrots rather than sticks. A lot of Red states are benefiting from the onshoring of manufacturing and other clean energy initiatives, for example. I think it would be hard to roll back the legislation given the number of constituents relying on the support it provides."

Furthermore, the IRA is not the only factor at play here. "There are state initiatives," Whitcher says. "Plus, seven out of 10 of the world's largest corporations have net-zero goals. PPAs procured by corporates in the US alone increased from 1.5GW in 2016 to 17GW last year. The drive for decarbonisation is growing irrespective of whether federal support is there and so it is hard to envisage the legislation being materially undone."

Chapman adds that there was bipartisan support for the IRA when it was brought in because of the way the messaging was positioned. "Previous legislative attempts focused exclusively on climate change, which made them instantly contentious. Climate change is still a central theme here, of course, but there is also emphasis on energy security and jobs, which is something both parties can get behind.

"That future-proofs the IRA to some degree. In any case, it is very hard to roll back legislation that a prior administration has brought in. Trump tried extremely hard to overturn Obamacare but only managed a rebrand."

From slow beginnings, the US is rapidly positioning itself as one of the most innovative and vibrant energy transition markets, says Chapman. "The IRA has catapulted the US to a point where it will very quickly catch up with Europe in terms of dollars

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> **BRUCE CHAPMAN**
> **Threadmark**

invested into the energy transition and, ultimately, I think it will surpass Europe, in particular when it comes to newer technologies, outside of traditional solar and wind."

Ares primarily focuses its energy transition activities on the US precisely because it has always been a couple of steps behind, according to Pike, and because the market is highly fragmented. "Those characteristics have meant that energy transition investment opportunities for managers in this market have been strong. We strive to be in markets where market share is not the key metric of success, and we believe that US energy transition infrastructure growth provides abundant opportunities for many participants."

Meanwhile, the IRA is not the only piece of legislation to have stimulated the sector. The Infrastructure Investment and Jobs Act, while not as momentous for the asset class, has also had a role to play.

"The Jobs Act is providing many direct and indirect benefits to all infrastructure sectors, not only transportation, which is of course its primary focus," says Abularach. "For example, in addition to supporting the renewal of ageing transportation infrastructure, it is also providing money to improve grid interconnections, helping relieve a major bottleneck for renewables.

"In addition, the Jobs Act is providing several billion dollars for investment in broadband in a bid to bridge the digital divide. That will benefit a vast number of fibre businesses that are positioning themselves for Broadband Equity, Access and Deployment funding, or BEAD money as it has become known. That will start to become available in 2025, but mobilisation has already begun."

Furthermore, the Jobs Act has allowed developers to get grant money from the Department of Energy for feed studies around emerging energy transition technologies, according to Pike. "Now the IRA is providing an incentive structure to support the next stage of development where those feed studies produce optimistic results."

The Jobs Act also promises to revive a languishing public-private partnership landscape, although the results are unlikely to be felt any time soon. "Two of our current clients have a transport focus that includes PPP investment," says Chapman. "The benefit of the Jobs Act to those strategies predominantly comes in the form of improved sentiment right now. It takes such a long time to procure investment through PPP structures, which means that direct benefits to dealflow are yet to be felt.

"PPP has been presented as the pot of gold at the end of the rainbow for a long time, but has at times struggled to deliver. It is such a politically influenced space that LPs have grown reticent about overexposure. Seeing a strong federal impetus behind the space will undoubtedly prove positive in terms of giving investors comfort, but these things take time."

Tax credits

Despite the undoubted boon provided by the combination of the IRA and Jobs Act, market participants still believe there is more that could be done to smooth the path of infrastructure investment. The tax credit market, in particular, requires finessing.

"The transferability of tax credits is promising but still very new," says Whitcher. "Markets are starting to develop, and technologies are emerging to facilitate that, but new mechanisms are needed to grow the number of tax equity participants required to support further build out."

It will be interesting to see how the tax credit market evolves. "Tax credits have largely been absorbed by a handful of banks to date," says Chapman, "but over the past few years corporates have started to come in. Initially, this involved tech companies with a direct interest, but more recently Toyota and Nestlé, for example, have entered the space as well. It could be that the market will evolve in a similar way to the direct lending market in the wake of the financial crisis.

"Banks will still have an important role to play, but a whole host of other players may also look to come in, developing increased sophistication over time. Clearly, a lot more money is required for tax credits than has been available over the past decade."

Pike, meanwhile, believes that direct pay rather than tax credits is the answer. "Everyone wants the tax credit market to develop faster, but the rules of engagement have yet to be defined. Personally, I am not sure that transferability alone is sufficient. Direct pay is another efficient route to go.

"Expanding the concept of direct pay would create a much more fluid market, providing greater liquidity and deal execution. For me, cleaning up and improving how direct pay works is a logical next step."

Permitting and approvals represent another significant bottleneck for the industry, adds Abularach, who cites the fibre sector as an example. "Delays are being caused by utilities failing to provide the necessary approvals in a timely manner and in many cases within the timeframe stipulated by regulators. Legislation is one thing but there also needs to be enforcement."

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>
> **ANDREW PIKE**
> **Ares Management**

"We need to see improved processes around siting and permitting, whether that involves renewables, CO_2 pipelines, sequestration hubs or hydrogen hubs," says Whitcher. "New York, for example, authorised the creation of a new division focused on just that – the Office of Renewable Energy Siting. We need state, federal and local governments to come together to speed processes up."

New York's new permitting office could prove critical for the rollout of renewables in the region. This is just one example of a local or state-led programme proving transformational.

"There have been a huge number of important local and state initiatives over time," says Whitcher. "California mandated the use of what was a new technology – batteries – back in 2010, for example, and just look at where batteries are today. Massachusetts is mandating that utilities procure offshore wind. New York City is forcing buildings to make energy efficiency improvements.

"Historically, it has been these sorts of local and state-driven initiatives and mandates that have led to real change. Hopefully, we will now see similar initiatives and mandates creating demand for new technologies like hydrogen, ultimately driving down costs and making them economically viable."

It is precisely the fact that different states are progressing their own policies in relation to federal legislation that will make it harder to unwind the IRA, says Abularach. "What has happened at a federal level has motivated change in both Red and Blue states. This is not something that can be thrown into reverse."

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DAVID WHITCHER
I Squared Capital

Deflating inflation

In addition to the dramatic increase in momentum behind the energy transition and supportive new legislation, the US is also benefiting from the relative positivity of its macro outlook. "The US has the most vibrant economy in the world," says Chapman. "It is typically also the fastest to take its medicine.

"Clearly a reset was required, and the US has done what was needed in order to bring inflation under control. From a capital allocator's point of view, that has huge benefits, and investors are certainly feeling more comfortable with where inflation is in the US versus Europe. It is no accident that a lot of investors that we are talking to in Europe are currently placing the US at the front of the queue in terms of where they expect to deploy most capital in the second half of the year."

Abularach adds: "The US Federal Reserve appears to be at or near the end of its tightening cycle and this informs greater consensus around what a 'new normal' looks like in terms of the risk-free rate. It is very difficult to price an investment when the risk-free rate is in significant flux, and I think this greater clarity is a big reason why deal activity has picked up materially in the US over the past three months."

Pike, meanwhile, says that even in an inflationary environment, counterparty demand meant that infrastructure has not seen the same margin compression that has been experienced in other asset classes. "Corporates and consumers' interest in climate infrastructure means our asset class has had the benefit of passing inflation-related costs through to end users."

"The nature of infrastructure is to be long-term investors, and we are going to experience cycles," says Whitcher. "But what is clear is that the demand for capital to support new infrastructure, particularly around the energy transition, is vast and ongoing. The volume of dealflow is phenomenal. This is a really exciting place to be investing right now."