Is there money for renewable fuels? Latest perspectives on financing renewable fuel projects

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Connecting people from renewable fuels companies with projects they want to finance to the people who can finance them was a key goal for Parhelion Underwriting's recent virtual roundtable.

The finance panel included Justin Goldstein from Goldman Sachs, John May from Hamilton Clark and Maximo Blandon with Stephens Inc. and the renewable fuels sector was represented by Ted Kniesche of Green Development Capital, Jordan Solomon from Ecostrat and Mark Riedy of Kilpatrick Townsend & Stockton LLP.

In today's Digest, is there a shortage of investment money in the biofuels sector, what are the biggest risks, key themes that emerged from these finance experts, and more.

From their views of the market several themes emerged.

As a creation of the 21st century, renewable energy is an emerging industry and like any **new industry** there are **new risks**; new technology, regulatory, feedstock, offtake and commodity market risks that must be explained and understood by the financial markets.

“The biggest risk – and the most valuable asset – is technology that is new or at first commercialization”. Insurance has become the alternative to an EPC contractor to wrap a project but at a price: 5%-15% of the loan depending on the risk as established by the insurers’ engineers, the length of the policy and how much debt service is insured. Technology insurance is evolving: the policy period was 10 years, then 15 and now 20 years and it looks likely that coverage will be extended to equity investors.

Feedstock risk has often been a barrier to project financing because of the fragmented networks of mostly small producers. A recent important development is the BSCR Standards, validated risk factors and indicators for agricultural and wood biomass supply chain systems. “The Standards enable capital to better structure around feedstock risk”

In an offtake agreement the off-taker buys all or a substantial portion of the output from the facility and provides the revenue stream supporting a project financing. “Every project finance lender in the world scrutinizes offtake agreements because lenders rely on the contracts to provide the financial assurances they need to validate the cash flow forecasts that form the basis for loan repayment”.

Commodity price risk is the possibility that commodity price changes will cause financial losses for producers of a commodity. Futures, options and insurance are financial instruments commonly used to hedge against commodity price risk. “Factors that can influence commodity prices include politics, seasons, weather, technology, and market conditions”.

It’s also an industry still heavily influenced by **government policies** that combat climate change, so that in financing U.S. renewable fuels projects the environmental commodities – carbon credits that are the currency of those governmental policies – are often more valuable than the fuel itself. “Many projects would not get financing without the projected revenues from the credits”.

In financing the American renewable energy industry, the debt market in particular worries that a change of law or regulation might eliminate the underlying Carbon Credits or LCFS or RIN markets – so “renewable fuels projects find that the capital market wants to protect its debt service in the event that the market is wiped out because a law is repealed, amended or terminated”.

Yet, despite the risks, there’s no shortage of money currently interested in the sector. “There are billions of dollars going into this space and we are poised for a significant investment in the sector”.

“It’s difficult to get non-recourse loans from commercial banks unless the deal can be de-risked”. Traditional lenders are unwilling to take merchant and regulatory risks. But the tax-exempt bond market, propelled by IRS exemptions for solid waste and wastewater projects, has moved into the space, along with some infrastructure funds.

The tax-exempt bond market has become more flexible. “The lenders look firstly for equity sponsorship (litmus test is 30% equity) and best if there are deep corporate pockets, but either way, the idea is that the developer should be wiped out first!”. Advice to developers – squeeze out risk as far as cost-effectively possible because “lenders aren’t looking for home runs; they are the least at risk in the capital structure”.

We noted several market trends. We are seeing “renewable fuels and gas replacing fossil fuels in fleet buses, the marine fuel industry and long-distance trucking and some of those projects are coming up for financing”. We have also seen “a new phenomenon: refiners, such as Exxon Mobil and Phillips 66, converting to renewable diesel”. And there is a strong movement towards reducing Carbon Intensity (CI) scores by using solar, wind and renewable natural gas projects.

Opportunity zones are opening up financing on some projects. An Opportunity Zone is an investment program created by the Tax Cuts and Jobs Act of 2017 allowing for certain investments in lower income areas to have tax advantages.

And there is lot of enthusiasm for Carbon Capture & Sequestration (CCS) projects in California’s LCFS and a Federal tax credit, 45q, was amended to impose a time limit: all CCS projects that are up and running before January 1st 2024 will be eligible.

About the Author

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