European investors eye Indian renewables opportunities

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Please send comments on the Indian renewables investment opportunity to info@cmyconsultants.london

India has for several years been touted as the next big renewable energy market – but European investors have found it difficult to access attractive projects and analyse the risks of investing in the country. This could be about to change amid a drive by European governments and the EU to boost clean energy investments in India.

When a country's prime minister sets a target of installing more than 100GW (100,000MW) of renewable energy capacity, it is hard for industry investors not to take notice — however aspirational the target might be. That is why renewable energy and infrastructure investors are expressing excitement about the Indian clean power market, especially after Prime Minister Narendra Modi said in 2014 that the power-hungry country aims to build a whopping 175GW of renewable energy by 2022. This would be a massive jump from the circa 5GW of solar and 25GW of wind installed in the country to date.

On top of the strong government support for renewables in India, costs have fallen to near grid parity for solar – meaning it is almost as cheap as generating power from fossil fuels. Project returns are at least in the low teens and can climb to the high teens. These are good conditions for a country that wants to rapidly increase its energy supply, while weaning itself off coal and gas. At the moment, around three quarters of India's electricity is generated from fossil fuels, the vast majority from coal power. India also has the world's fourth highest coal reserves and so the pressure for it to develop using that source remains significant.

But despite many positive signs for renewables, not many Europe-based infrastructure and renewables investors have tapped into the booming Indian market. Some industry players are blunt about their view that India is not a transparent place to do business in. In many respects those fears are justified. The 2015 Corruptions Perceptions Index, for example, put together by NGO Transparency International, gave India a 38/100 score, based on how corrupt a country's public sector is. Zero is highly corrupt and 100 is very 'clean', meaning India scores poorly.

That's not good news for investors, as the government owns the country's utilities and manages its renewables tenders.

Other investors say they have struggled to find local partners and cannot enter the market on their own. But the most obvious near-term challenge for international investors is that domestic debt is expensive – it can cost as much as 12% for renewables projects. Currency hedging costs makes it equally expensive to raise debt from non-domestic lenders for Indian projects. All of these factors have put investors off from "going big" on Indian clean energy, despite the strong market fundamentals.

But this could be about to change. Firstly, competition for European renewables assets is so fierce that returns are often driven to too low levels for some of the most seasoned funds in the market. While this has been the case for some years, this challenge for investors is just going to continue and they need to find a way to secure their target returns. On top of this, other emerging renewables markets where investment conditions are perceived as easier than India – for example Brazil — have slowed down. India, which was rated as the third best country for renewables investments by EY in its latest quarterly Renewable Energy Attractiveness Index — beaten only by the US and China — could be the next country in line to attract significant investment interest.

Secondly, and more importantly in the short-term, the UK government, the French government and the European Commission have all taken steps to help boost co-operation on clean energy investments with India.

The UK's initiative was launched as part of wider strategic co-operation with India, announced in November last year. Modi said at the time that India needs "large-scale, low-cost and long-term finance" to deliver its renewable energy ambitions and noted the potential role that the City of London could play in leveraging international finance into India.

Charles Yates, a renewable energy consultant at CmY Consultants in the UK, is involved with several of the initiatives backed by UK government entities to boost

Indian clean energy investment. He says that the government is trying "to understand what the opportunities are and then do some matchmaking to help UK investors invest in renewables with partners in India."

The matchmaking efforts have been intensive in 2016, when several events, roundtables and one-to-ones between Indian and UK investors hosted to drum up interest in the Indian market. The events have been paid for by the British High Commission. At the Summit on, UK Investments in Indian Renewables, hosted in London in late March, Amit Rama, a director of UK Climate Investments – a joint venture between the GIB and the Department for Energy and Climate Change (DECC) to invest in renewables in developing nations – said the key challenge for commercial investors in India is foreign exchange risk. "It's expensive to hedge the currency, especially in long time horizons," he said.

This was echoed by other delegates (including potential investors and advisors), and has led Yates to recommend that the UK provides a hedging facility to help drive down the cost of hedging the pound against the rupee. "The Treasury is already talking about it," says Yates. This could be a game-changer for UK renewables investors wanting to enter India, which could then bring their relationship banks with them.

Karnam Sekar, deputy managing director and chief credit officer at State Bank of India, explained to delegates what type of debt structures the State Bank can provide. Debt tenors are typically around 12 years and debt-to-equity ratios 70:30. "But we can go up to 75 or 80%" in terms of leverage, he said.

He added that India needs more international debt providers and that the Ministry of New and Renewable Energy (MNRE) is in discussions with a raft of international development banks – some which have already committed to projects in the country – and hopes commercial banks will begin financing Indian renewables soon.

The EIB could also have a big role to play. In March this year, India and the EU made a joint declaration to co-operate on clean energy and climate. As part of this, the EIB will provide loans to Indian clean energy projects. According to the EIB's project loan website, it is considering loans for three different renewables portfolios in India.

A spokesperson for the EIB said that, "EIB lending for climate-relevant projects [in India] is a key focus for our engagement in Asia." The bank is, however, not considering to provide hedging facilities like those being considered in the UK at the moment.

The EU has also backed a project called Facilitating Offshore Wind in India (FOWIND) led by power companies and sector advisors to map out areas on India's 7,500km coastline where offshore wind farms could be built. A pilot 600MW project is already under development by Indian company Suzlon Energy. Last year, plans for a roll-out of more projects took a step forward when the Indian government approved an offshore wind policy that could see tenders being launched as soon as 2018.

Again, this has attracted funding from the UK government. Three UK consultancies – Yates's CmY Consultants, SeaChange Offshore and IT Power Consulting – are helping the Indian government to design the tender process, and their work is being paid for by the UK Foreign and Commonwealth office.

"We're helping India to develop tariffs, a tender structure and to raise awareness among offshore wind players like EDF and Dong Energy," says Yates. He adds that the expectation is that European utilities would "bring international expertise" and bid for tenders when they launch. There are also push factors influencing European investors. For, example, the European offshore wind market is expected to slow down after 2020 – especially in key markets like the UK and Germany – as governments cut subsidies for projects. If India's tenders are structured in investor-friendly ways and without high local content requirements, then utilities are likely to look to India when Europe's pipeline dries up. This would generate opportunities for infrastructure funds, since almost all utilities building offshore wind projects bring in investment partners due to high capex costs.

Inevitably, there are several challenges that could stand in the way of India having offshore wind tenders up and running in the next three to four years. Raising project finance debt at competitive prices is even more important for offshore wind than onshore and solar – the latter can be built on an all-equity basis but most offshore wind farms require a debt raise at some stage because they cost more to build and operate.

Utilities that already have footprints in the Indian renewables market are French giants Engie (which has bid and won capacity in India's solar tenders through its subsidiary, Solairedirect), and EDF, which owns both solar and onshore wind assets in the country.

Clean energy was a key topic when French president Francois Hollande made a three-day state visit to India in late January this year and announced that France's development agency ADF would fund Indian solar projects to the effect of EUR 300m. During the visit, state-controlled EDF also announced a new 50:50 joint venture with Indian developer SITAC Group to develop 142MW of onshore wind capacity in the state of Gurajat by the end of this year. The involvement by the French state and EDF in Indian renewables could trigger interest from French fund managers to join these investments.

While few European asset managers have invested in Indian renewables, US investor I Squared Capital bet big on India in August last year when it acquired USD 150m of equity in Amplus Energy Solutions, an owner and operator of distributed rooftop solar power in India.

I Squared is not a renewables-focused investor per se. Its energy investments include natural gas projects in the US and Northern Ireland. "Two things stand out to us about the Indian market," says Gautam Bhandari, a partner at the firm. "First, investments in renewables work because of good underlying solar radiation in the country as well as good wind speeds in certain areas. "Second, at current prices, renewable energy is commercially viable without a subsidy. Solar in particular is competitive with conventional generation."

The so-called balance-of-plant costs – meaning most the equipment needed to build a solar project apart from the panels, such as wires and the mounting system – for solar projects is cheaper in India and Asia than in many other countries, since local firms that provide balance-of-plant are very cost efficient, adds Bhandari. Amplus installs solar panels on industrial and corporate rooftops owned by the likes of Yamaha, Hilton, Whirlpool, Delhi Metro and Walmart. The electricity generated is then sold back to these customers through long-term PPAs.

Due to this, I Squared does not suffer the land acquisition issues that developer's of Indian onshore wind or ground-mounted solar projects are facing. Land acquisition can be an issue for investors because many solar projects and their related transmission infrastructure are built on small and distributed land holdings where disagreements between land owners can delay transfers of land ownership to renewables developers.

For now, I Squared Capital has also chosen to finance projects with 100% equity, avoiding expensive debt and hedging costs – but Bhandari says he will raise debt when Amplus's portfolio achieves scale and is more diversified. He questions the 12% debt cost often quoted by industry participants:

"If you have a high quality counter-parties with good credit backing, then you can get 10-11% and in fact, we have been able to negotiate debt prices below 10%," he says.

But he agrees debt costs are a challenge, and if the UK government could provide a foreign exchange hedging facility "then UK developers will have a good advantage". Armin Sandhoevel, CIO of infrastructure equity at Allianz Global Investors (GI), agrees that if governments or multilaterals could provide hedging facilities or credit lines, that could boost investment interest in the Indian market.

Sandhoevel said in a public forum in 2009 that Allianz GI was looking to invest in Indian renewables, but the investor – which raises third-party funds from LPs to invest in renewables, unlike the captive funds run by Allianz Capital Partners – is yet to do so. The reason for this, he says, is that Allianz GI has remains focused only on European renewables partly because it's LPs are "very Europe-focused and euro-focused". But he also echoes the challenges other industry participants have raised about doing business in India and finding the right partners to make that first investment with. But he remains convinced that Allianz will acquire Indian renewables projects at some point. "We have a very positive view on Prime Minister Modi – his agenda is an important component for renewables development in India," says Sandhoevel.

He adds that there are good fundamentals for solar as well as the sizes of individual projects – solar projects are often larger than 250MW, while a 25MW solar asset in Europe is considered a large one. Allianz GI is currently in the process of building up contacts in the country that it could potentially partner with on projects in the future.

One potential partner for international investors looking to enter the market is SREI Infrastructure Finance Limited, an Indian infrastructure investor and advisor.

It has, for example, worked with UK solar investor and operator Lightsource, which aims to invest GBP 2bn to develop 3GW of Indian assets with local partners. Lightsource announced a five-year plan last November during Prime Minister Modi's visit, saying its first projects will be developed in partnership with SREI. SREI has been listed on the London Stock Exchange since 2005 and is also backed by a raft of development banks including KfW and DEG in Germany, Dutch FMO, Belgian BIO and Finnish Finfund.

Hemant Kanoria, chairman and managing director of SREI says that he has recently experienced an increase in European investor interest in Indian renewables. He adds that there are opportunities in all types of clean energy technologies and that many local developers are looking for co-investments. But he believes that investors looking to enter the market should remember the size of India, which makes it "not just like a country but almost like a continent". Support for renewables can vary from state-to-state, so investors "should look at the loans [and incentives] available in particular states," he says.

Issues of finding the right partners and securing a lower cost of capital to build projects in India could be addressed by governments and multilaterals in the near to medium term and trigger the influx of international investors that India needs to meet its ambitious renewables goal. But looking further ahead, there are other challenges that could dent investment interest in the market.

One key problem is the stability and capacity of the country's power grid. "The regulator needs to address this," says Bhandari. "Balancing payments for operators that could quickly supply power to the grid when renewable power supply is low, would help stabilise the grid." "Some specific incentives need to be in place to achieve long-term grid stability – they're available in most developed markets but are yet to find their way to India," he adds.