RENEWABLE ENERGY

Capital Market Instruments for Renewable Energy

Summarised by Energetica India

The rapid decline in technology costs has increased investor appetite for renewable energy investment projects. This in turn is making more capital available in many parts of the world. Green Bonds and Yield Companies (Yield Cos) are two innovative mechanisms gaining prominence.

The rise of Green Bonds and Yield Cps has been underpinned by strong government commitments to establish an attractive market environment for renewables and by private sector interest in funding renewable energy projects. Such instruments open up opportunities to new classes of capital providers in the renewable energy sector while providing the necessary liquidity in the market and helping to reduce the cost of capital.

Green Bonds

Green bonds are used increasingly as vehicles for institutional investors to invest in renewable energy assets in capital markets. They can offer a means for borrowers to raise large-scale, long-term financing from non-bank sources and at relatively low cost. The potential for the continued growth of green bonds needs to be further analysed because their success thus far relies on the high credit-rating of the issuing entity.

In 2015, nearly half the USD 41.8 billion green bond-labelled proceeds went to renewable energy projects making renewables the biggest sector in the green bond universe. In 2016, more than USD 62 billion of green bonds were issued in the first 10 months alone making this a record year (see figure 1). Interest in Green bonds is growing rapidly particularly in emerging markets led by India and China. More recently Mexico and Brazil also issued inaugural green bonds in December, 2016.

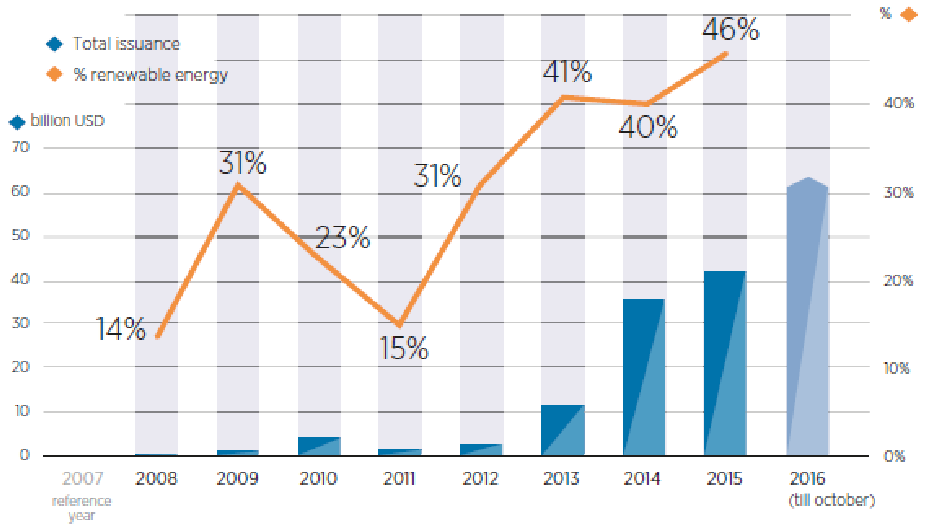

Figure 1: Growth in the global green bond market and renewable energy share; 2008-2016

YieldCos
The yieldco structure emerged in 2014 as an option for energy utilities and other renewable energy asset owners to spin off operative assets from their balance sheets to develop finance and implement new projects in a typical yieldcostructure; an entity transfers its operative renewable energy assets into a new company it fully owns. This new entity is listed thereafter, and new equity is raised through a share issue, while the parent company typically remains as a significant minority owner in the yieldco. As yieldcos grow through the purchase of stable, operational assets from parent companies, they can enable institutional investors to invest equity directly in corporations and thus own operational renewable energy assets.

The sharp decline of most US yieldco share prices in 2015 by an average of 40% raised concerns among many investors. Prices fell because the yieldcos could not raise public offerings at high rates and were unable to acquire new assets that could deliver steady cash flows for dividend growth. As a result, no equity was raised for a period of time.

However, there were signs by late 2016 that the US yieldco market was starting to recover grounddespite steep price reductions in various stock markets and the financial difficulties of some parent companies in 2015..A number of yieldcos announced plans to issue new shares in 2016, although the scale was much smaller than before. In contrast to the period before 2015, the initial public offerings in 2016 were considered to reflect more realistic valuations. Yieldcos again have begun to acquire operating US wind power assets with some yieldcos showing growth potential to acquire projects on the open market.

Green bond markets in India and China
India's green bond market is expanding quickly, with more than USD 1.1 billion issued during 2015, and a total of USD 800 million in the first eight months of 2016. Following the inaugural green bond issuance by Yes Bank in February 2015, the Export-Import Bank of India and the Industrial Development Bank of India also raised funding via green bonds. Since then, the Indian market has seen the first corporate green bond issued by a wind power project developer; the first certified IndianGreen bond to be listed on the London Stock Exchange; and the first green bond issued by India's largest power utility.

This rapid growth is due largely to the Indian government's strong commitment to supporting green financing mechanisms. In January 2016, the Securities and Exchange Board of India released its official green bond requirements, establishing guidelines for reviewing, reporting and tracking the progress of green bond issuance.

China is the world's single largest green bond market. Chinese issuers led issuances in 2016, contributing to about one-third of totalvolume in the first nine months of the year. The Chinese government offers tax exemptions or subsidies for green bond insurance to reduce financing costs and is currently creating national standards and regulations.

In December 2015, the Green Finance Committee of the China Society of Finance and Banking published the Green Bond Endorsed Project Catalogue, which sets criteria for various projects and businesses to qualify as green. In September 2016, the People's Bank of China (the country's central bank) released green financing guidelines that highlight the national government's support for green bonds.

This prompted the Bank of China, one of the country's largest state-owned commercial banks, to announce plans in September 2016 for the first green "covered bond" to be issued by a Chinese public entity. The bond will conform to both the People's Bank of China's Green Bond Guidelines and the international Green Bond Principles. This structure can improve the rating of the issuance, giving international investors easier access to the rapidly growing Chinese green bond market.

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