Don’t Panic – infra slumps happen

Angus Leslie Melville

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Having spent the last couple of weeks riffing off the funds report, it seems only fair now to gnaw knuckles and take a closer look at our first quarter greenfield report for infrastructure financing… which has a very different tale to tell.

Before launching into today’s Friday Editorial, let’s clarify – something we should do for our awards so people submit for the right ones – *IJInvestor* focuses on infra fund fundraising and M&A, while *IJGlobal* league tables are for greenfield financing and refinancing.

Both databases are exclusively infrastructure and energy… but that hits grey areas when infra funds skip merrily into Core+ while casting a covetous eye on Core++ (pretty confident there’s another + on the way). However, if an asset is held by an infra fund, we log its ownership (however we may shudder). On the greenfield side, we can be more purist in our translation of infra/energy and it has to fit with our criteria.

For reference on Q1 2022 reports, you can read (open access) news stories on the IJInvestor Funds & Investors Report and the IJGlobal Q1 League Tables. Obviously, if you want to access the full reports (labours of love by our splendid data team), you’ll have to put your hand in your pocket!

A tale of 2 reports

The reports could not be more different. Infrastructure funds have been going gangbusters on fundraising all the while M&A has been rampant. Infrastructure finance (greenfield and refi) on this other hand has slumped alarmingly.

In Q1 2022, there were final closes on unlisted funds to the tune of $65 billion which is staggering given that full-year 2021 (a record year for fundraising) saw final closes on $136 billion. Given the direction of travel, that record is likely to be blown out of the water for FY 22.

Meanwhile, M&A in the first quarter recorded almost $95 billion of cash being deployed, with North America and Europe dominating activity on $51 billion and $36 billion, respectively. Just looking at this from the funds perspective alone, we can expect this to continue to spiral given the amount of dry powder out there.

However, it’s a very different story on the greenfield front with Q1 recording the lowest number of deal closes since 2019 – only 602 transactions across the globe closed in the infra space, compared to an average of 810 (2019-21). Deal value has also cratered at $285 billion for Q1, a 31% decline on Q1 2021 and a 20% fall on average.

Global project finance for the period reached $127.4 billion, maintaining its healthy trend. The rest of the infra deals slumped to $157 billion – 48% lower values than Q1 2021 and 35% lower than average. Meanwhile, banks lent $72.2 billion globally, representing a 33% decrease as compared to average quarterly figures.

So – what went wrong?

Well now, where to begin? Russia's invasion of Ukraine doubtless carries a share of the blame for impact on deal flow… but given it started almost two-thirds of the way through Q1 – 24 February – it cannot shoulder all responsibility for the quarter's poor performance.

Talking this week to sources around the industry, there are some fundamental reasons for a dip in greenfield activity… and the finger of blame is squarely pointed at our old friend Covid-19.

However, there is a two-pronged approach to the pandemic blame game.

First of all, the impact of rapidly-rising commodity costs for core inputs into infra projects – steel, copper, etc. – is putting a significant dampener on new developments.

As one source says: "In the last 3 months, there has been a trend of either not getting a fixed-price EPC contract for a bog-standard building or getting one at such an eye-watering level – embedded risk premium – that it doesn't make sense.

"It's hard for those developers to then try and raise financing. Pity the poor developer trying to convince your typical project finance lender to take a view on construction cost contingency with no EPC in sight."

And then you have a very different impact of coronavirus which – in the low-interest environment of 2021 – saw a host of refinancings pushed through to the point, its pretty much all been done. This, of course, was compounded by a relatively quiet refi year in 2020 when market uncertainty resulted in a détente… which was more than made up for in the 2021 bumper year.

As another source (one with a delightful eye for imagery) says: "It's like a boa constrictor eating a deer… the market is currently digesting the 2021 meal!"

But it's not fair to say that refinancing is off the table right now. It's quite clearly still progressing… but debt pricing is heading up due to the Ukraine invasion and a number of other market uncertainties to the point where one source ponders: "Do I run a 2%, 5% or 9% case?"

And then you have to look to evolving government spending priorities – defence versus social spending to combat rising prices versus net zero cost realisation, and such like – and you have what one source describes as "the perfect witches' brew" for someone planning a greenfield project. Clearly not having benefited from a classic education, the source added: "Bubble, bubble, stir and trouble."

The whole conundrum is rounded off nicely by one source: "Uncertainty, busted supply chains, high inflation, energy crisis, war, political disagreement, trailing Covid in China… no one except hedge funds invest in that environment."

So – what now?

Anyone with access to the internet and the ability to browse everything from the BBC to your favourite infra title – that's *IJGlobal*, obvs – will be only too aware of the energy security debate and the Russian O&G dilemma.

It's a bit obvious to say it, but it has to be said all the same… no matter what the market conditions, we are going to see fast procurement of renewable energy (lots of it) with associated energy storage, and LNG terminals (lots of them, some floating)… even hydrogen (however the hell that's going to work).

Bottom line – anything that helps achieve energy security as Russian sanctions are increasingly rolled out across Europe and much of the rest of the world – is getting the green light.

Just look at the news from recent times on IJ, you have Poland – which currently relies on coal for 70% of its energy generation – ramping up its plans for offshore wind, but that kicked off before the Russian invasion.

The Poles are also moving fast on solar with the EBRD recently announcing it was lending PLN 212 million ($49m) to Stigma, the SPV delivering its biggest (285.6MW) PV plant, to be located in Zwartowo in the north of the country.

A little closer to home for this infra hack, the UK launched the British Energy Security Strategy – a plan to accelerate wind, solar, hydrogen and nuclear projects. The key points are: 24GW of nuclear power by 2050; 50GW of offshore wind by 2050 (including 5GW of floating); 10GW of green hydrogen production by 2030; grow by 5x current 14GW solar capacity by 2035.

Austria is also stepping up its game, announcing it will provide €250 million ($275m) to support the development of renewables, with the state of Lower Austria also passing measures to ease permitting processes for solar and onshore wind. This financing is part of a wider €2 billion subsidy package to relieve the country from dependency on Russian gas.

Germany has eased the process for permitting onshore wind to speed up its renewable energy expansion. Among other things, it proposes a simplification of the assessment of collision risk for endangered bird species (likely not good news for seagulls).

Given its reliance on Nord Stream, Germany figures frequently in the news as it regrets Glasnost decisions to support Russia as it emerged from Soviet rule. It was announced that grid operator Amprion will invest €4 billion by 2026 into an 8GW grid expansion across North Rhine-Westphalia This will enable the transport of electricity from wind farms in the North Sea and follows its announcement that it plans to install 30GW of offshore wind energy by 2030.

This week there was news that impacts Germany and the Netherlands – TenneT successfully issued a €3.85 billion ($4bn) green Eurobond to invest in renewable power transmission in both countries. Proceeds will focus on connecting large-scale offshore wind farms to the grid and investments in the onshore transmission grids.

In the Netherlands alone, the government has identified 3 new areas – and confirmed 2 previously designated areas – for the development of offshore wind farms in the North Sea. In one fell swoop, this adds 10.7GW to the pipeline.

Oh there is so much more, but only so many I can be bothered digging out.

And there's always hydrogen…

Hydrogen remains a mystery to me. I can see its application on site, but not as an energy source to proliferate society. For example, there was news of ArcelorMittal successfully trialling the use of green hydrogen in the production of direct reduced iron (DRI) at Contrecoeur in Quebec.

This makes perfect sense for hydrogen and in the 24-hour trial, ArcelorMittal Long Products Canada (AMLPC) used power from an electrolyser to replace 6.8% of natural gas in the iron ore reduction process.

But I quake slightly when reading on IJGlobal about plans for RWE to build a terminal for the import of green ammonia near an LNG project it is developing alongside partners Gasunie and KfW in Brunsbüttel, Germany.

It sounds all very worthy, but I cannot help but think back to ethanol projects in the US which went gangbusters years back. In 2005 there were 2 project to reach financial close, immediately ramping up to 9 in 2006, then slowing down to 5 in 2007, only 2 in 2008 and 2011 each, then a final lonely project in 2014. Nowadays, it's a bit of a swear word.

What can I say, where there is no immediate – neighbouring – industrial application for hydrogen (from metals through to powering buses), it just give me the heebie jeebies.

Frankly, it's a crap shoot… where you're hoping someone turns up with the dice… coz the tech ain't there!

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