TRANSCRIPT
PENSIONS FOR PURPOSE PODCAST, SERIES 2, EPISODE 12
THE ROLE OF PRIVATE MARKETS IN THE ENERGY TRANSITION

Laasya Shekaran, Pensions for Purpose: Hello everyone, and welcome back to the Pensions for Purpose Podcast. I'm your host, Laasya Shekaran, and on today's episode, I'm joined by Raza Ali from AlphaReal.

AlphaReal is a specialist, real assets investment manager, and they've been investing in renewable energy assets for over a decade. To date, they've deployed over £1bn across 180 operational assets, and more than that, are in construction. Raza is very much involved in all of this work as an Investment Director in the Renewable Infrastructure Team. So welcome, Raza, it's great to have you here.

Raza Ali: It's great to be here, and thank you for having me.

Laasya Shekaran, Pensions for Purpose: My Pensions for Purpose co-host for today's episode is our CEO, Charlotte O'Leary. Welcome, Charlotte, it's really great to have you back on the podcast.

Charlotte O'Leary, Pensions for Purpose: It's really nice to be here, Laasya, with you and Raza. Thank you very much for welcoming me back.

Laasya Shekaran, Pensions for Purpose: Brilliant. Let's get straight into it. So, Raza, we hear a lot in the news about renewable energy, about net-zero. We know the UK Government has set a goal to get to net-zero by 2050, and to decarbonise the electricity system by 2035. How is it actually going to get there, and is the government expecting private investors to play a role in this transition?

Raza Ali: As our listeners will know, the UK's transition to net-zero by 2050, and a fully decarbonised electricity system by 2035, is already well underway, and private capital is central to that ambition. Government sets the policy direction, but it's private capital delivering the funds.

We see technologies like solar, wind and battery storage have all drawn strong investor interest, and now at AlphaReal, we are helping to accelerate this shift by deploying capital into these high-quality UK renewable assets. Also, we find that there's an increased focus by investors looking to potentially invest more in the UK, which is exactly what we do at AlphaReal. More latterly, the Pension Bill reforms have pointed to an increased demand for private assets in the UK by institutional investors, which provides a tailwind for renewables, as well as secure income more generally.

Laasya Shekaran, Pensions for Purpose: It's interesting what you say about how government sets the policy direction and then private capital gives the funding. Do you find that the policy direction is clear, or does it change a lot? We had a new government last year, for example, and that can change the direction of travel. What is your take on that?

Raza Ali: Well, with the recent appointment of the UK Labour Government, what we have seen is an increase in ambition to deploy renewables in the UK. Now, alongside that, decarbonising the UK energy mix will inevitably require policy and regulatory changes, and there are a number of challenges that the industry is grappling with at the moment. A lot of that uncertainty, we expect, is going to be resolved over the next six to 12 months, and this is all with the aim on delivering on that greater ambition that I mentioned earlier.

Charlotte O'Leary, Pensions for Purpose: It's good to hear from you, Raza, on this, because there's so much going on in the business space, but also in the pension fund and broader investor space. You may well know that Pensions for Purpose worked with the Impact Investing Institute and The Good Economy on a paper around place-based impact investing and LGPS committing 5% to investing into local places. This is particularly bringing the sustainable agenda together. Now we're seeing that with the Pension Schemes Bill, and I'm sure it will go further than that.

So, it is a brilliant environment to be looking at these assets. What do we mean by renewable infrastructure assets, and why should investors consider making an allocation to these, given all of the things that we've just discussed?

Raza Ali: Absolutely. So, getting our terminology right, by renewable infrastructure, we are referring to those physical systems like solar farms, wind turbines and battery storage. These are technologies that generate, transmit or store energy from renewable sources. Coming back to that broader ambition, the UK currently has around 60 gigawatts of installed renewable capacity, although that figure varies depending on how you define things.

The UK will need over 100 gigawatts by 2035 to meet its electricity decarbonisation target. So, that gap represents a significant deployment opportunity for investors. Now, beyond decarbonisation, these assets deliver tangible financial benefits. These are long-term cash flows, which can often be secured through long-term contract for differences, or long-term power purchase agreements, and importantly investing in new builds, such as greenfield assets. This contributes to additionality by directly expanding the UK's clean energy capacity.

Lastly, I would add that in a world that is prioritising energy, security and sustainability, renewable infrastructure offers both strong fundamentals and measurable decarbonisation outcomes, making it a strong strategic asset allocation.

Charlotte O'Leary, Pensions for Purpose: Raza, just linked to that, about the incentive structure to get to the 100 gigawatts. We've noticed with any sustainability directive, generally, people go for the lowest hanging fruit first, the easiest opportunities. Where do you see structural issues around this?

Raza Ali: So, I think, first and foremost, the perspective that we bring to the picture is, we focus on financial returns for the investors, and in terms of the broader framework within which that operates. If there are additional sustainability outcomes that are desired on a social level, then for us, the most salient places to include those are within the planning process. So, for example, if there's a requirement to deliver biodiversity net gain. The reason why that's really important is because what it ensures is that all investors like ours have to take those obligations into consideration. So, it really levels the playing field, and so I think that is quite a powerful area, where policy amendments can be made for these renewable energy projects.

Laasya Shekaran, Pensions for Purpose: That's really interesting, because I think one of the pushbacks that sometimes happens when we talk about energy transition is the idea of how it will affect people - how it will affect people's jobs, for example. This concept of the just transition comes up quite a lot. Is that something that you think about when you're looking at renewable energy projects?

Raza Ali: From our perspective, a lot of those challenges are characteristically taken off the table. What I mean by that is that these are challenges that, fortunately or unfortunately, are considered by our developer partners. So, that is the side of the investment community that is out there securing planning and effectively, the necessary property rights.

What we are seeing from our experience is that some of those regulatory changes that I mentioned, such as grid reform - essentially, that is a shortening of the grid queue that is currently prevalent in the UK. We've got a massive queue of projects looking to connect, and so, there are processes in place to shorten that. A lot of those challenges are addressed by our developers, and I think this is where funds, like Alpha, come in, very much at the stage where projects are baked already. When it comes to obligations to the local communities or the siting of these assets, that is already set. I am absolutely sure that there's a lot of impact on developers, as you know with everything that you've just talked about. From our side, it is very much settled by the time we get there.

Laasya Shekaran, Pensions for Purpose: That's really interesting. and I guess it shows how important those relationships with the development partners are. I wanted to ask about the opportunity set when it comes to investing in renewables. Would you recommend investors hold different types of assets, should they focus on one specific area within renewable energy? What would your approach be?

Raza Ali: Absolutely. Our view is that we believe holding a mix of renewable technologies is essential to build a resilient and a future-proof portfolio. That's why, at AlphaReal, we take a diversified approach. We primarily invest in ground-mounted solar and onshore wind across different regions of the UK.

What we're doing is combining established, scalable technologies with a strong performance history, and crucially they complement one another from a generation profile. What I mean by that is that solar generation peaks during the long summer days, while wind typically produces more in the autumn and winter months, and so that seasonal balance helps smooth out the generation variability, and it creates a more consistent revenue stream.

Lastly, I'll add to that, renewables are by their nature intermittent, which provides the case for flexibility assets like battery storage, which is increasingly important. Those battery assets help to manage supply and demand. At Alpha, what we've done is we have also entered the battery space, cautiously. We're progressing our first storage project, recognising its potential to support renewables and enhance overall system stability.

I think it's important to probably step back and explain that we see the transition as an ecosystem, not a single play, and investors who combine core technologies with a measured exposure to emerging assets are better positioned to capture the upside whilst managing risk.

Laasya Shekaran, Pensions for Purpose: What are the emerging assets that you talk about? I'm perhaps less familiar with some of those.

Raza Ali: There's a variety, such as green hydrogen. There is electric vehicle charging, there's energy from waste. There's also small modular nuclear reactors; I profess to know very little about that, but I think it's demonstrative of the fact that in that context, what Alpha is doing is focusing on the tried and tested technologies. Eequally, I appreciate the listeners will want a broader question answered, which is what is the optimal mix for them?

We see those core technologies very much being part of a broader portfolio.

Charlotte O'Leary, Pensions for Purpose: That's really good at highlighting the potential for a closed-loop view of approaching renewables. Certainly, I've seen some interesting projects, for example, in Shetland, where they are combining technologies in order to supply communities, universities and link employers. So, I think there are some brilliant projects going on around the UK, and it does demonstrate why there is an appetite for the Government to support investors investing around the UK.

Of course, there are other elements to this in terms of development. One thing that anyone who has looked at these projects will know is that there are potentially pros and cons when it comes to greenfield versus brownfield assets. What are the pros and cons, and how would you approach these?

Raza Ali: I think again, perhaps for the benefit of our listeners, it's worth being clear on the terminology because we often get caught in industry jargon. By brownfield assets, we mean those that are already operational. Your wind turbine is spinning, or your solar farm is already generating electricity. By contrast, with greenfield, we mean those that are ready to build or already under construction. The point there is they're not yet generating power.

The key advantages to investing in brownfield assets is the immediate cashflow. They begin delivering returns from the point of acquisition. They offer also greater visibility on performance and risk, but equally those assets don't contribute to new, clean energy when they change hands, meaning that they don't offer additionality.

Now, by contrast, greenfield assets bring new renewable generation online, which directly contributes to the UK's decarbonisation goals. The trade-off is risk; there's construction, risk, planning and grid connection timings, as I mentioned earlier, can all impact delivery.

Coming back to AlphaReal, we mitigate those risks by firstly targeting fully consented greenfield projects only. So those are projects that have got land planning and grid connection already secured. We typically invest either very soon before, or during, construction, which allows us to refine the main construction contract. So that's an engineering, procurement and construction contract in the case of a solar farm. Then we manage the construction through to operation, and that gives us an active oversight program to ensure the assets are built to the standards that our investors require.

Finally, I think it's worth saying that both assets have a role to play. Brownfield assets offer stability and yield, and greenfield unlocks growth and returns, and there's an argument to say that combining the two - driving additionality, while delivering attractive risk-adjusted returns - is something to be pursued.

Laasya Shekaran, Pensions for Purpose: It'd be useful to bring this to life with a case study. So, I'm wondering if you could talk us through one of the assets in your portfolio, and go from start to finish. How do you decide which asset to choose - it sounds like you're looking at lots of different details, and you're deciding what to invest in - and then also, once you've selected an asset, what happens next? Is there an ongoing relationship? It would be useful to hear that story.

Raza Ali: Absolutely. I think the asset that I'd like to talk about is Rigmuir, which is a three-turbine wind site in East Kilbride in Scotland. The opportunity we filtered through a pipeline presented from a counterparty that has worked with Alpha for some time. They are also in the business of developing assets, and we felt that this type of greenfield opportunity suited our investment criteria very well. So, when investing in greenfield assets, as I mentioned earlier, we focused solely on fully consented sites. Again, in this instance there was a grid connection, a land lease and planning had already been secured, removing development risk.

Another characteristic of this, and our general approach, is that we take an unlevered, full ownership approach. Now we find that gives us greater control, enhanced cashflow security and the flexibility to structure long-term offtake agreements. So, in this instance, what made Rigmuir particularly compelling was its location, which is a high-energy yield, quite a windy site, on a disused landfill site, which was repurposed by our counterparty to host a clean energy wind turbine. So, it's a nice change in use there.

Related to that is our relationship with the construction partner, which has been very positive. In fact, we're working on a second project together, plus we've got other ongoing relationships with them in relation to our existing portfolio. With the asset itself, that project energised or started producing energy in late 2024, and pursuant to that, we signed a physical sleeve corporate power purchase agreement with a leading European packaging supplier, and the asset now supplies a meaningful share of their UK electricity needs, whilst helping to deliver a more stable return to our investors.

Laasya Shekaran, Pensions for Purpose: How does that construction partner relationship work? Because it sounds like that's quite important. How do you decide who those construction partners should be, and keep that strong relationship?

Raza Ali: So, this is where the original and initial underwriting is quite important, where effectively, there will be a suite of proposed contractors that are proposed for the project, and part of our underwriting will be to understand their experience, their track record, as well as to make sure that the contracts that we have in place suitably align interests and reward our counterparties for timely delivery. But equally, we have to assess what risks they are, and where they best sit with the counterparty that's best able to manage them.

I think the benefit of doing repeat business with developers that we know and have transacted with, is that both parties have had those detailed and sometimes tough conversations. What you do then is you end up with a set of documents that largely, people are aware of, and both parties understand the position. So, we do value that repeat business.

Laasya Shekaran, Pensions for Purpose: The example that you talked about is a great one for a very successful project that has delivered what it says it should. I'm curious about how the engagements would go if it wasn't meeting all of the expectations that you had. Does that ever happen, and how do you deal with that situation?

Raza Ali: Yes, it does, and there are examples. To give you one example, if the connection date for a project is later than originally planned. There's a couple of ways of looking at it, but from a financial perspective, a lot of that buffer is already built into that construction premium, or the construction risk that the deal team will factor into its evaluation: the price that it basically pays for that project. When it comes to actually managing the risk, what we have is a large portfolio team, and they are responsible for keeping on track of construction progress, as well as through our externally appointed specialists - they're called owners engineers, and they monitor the construction programme very carefully.

Lastly, when delays arise, there's a root cause analysis that we, in conjunction with our specialist advisors, inevitably undertake, We try and understand what the cause of the delay is, and where does that sit under the contract. A lot of this will come down to what the cause of the delay is, so if it is something that is the responsibility of our counterparty, then generally there will be financial compensation mechanisms within the contract that protect the returns to our investors. Equally, if there are things, say related to the grid, then ultimately what happens is that that comes out of the overall buffer that we include when we initially price these assets.

Charlotte O'Leary, Pensions for Purpose: Thanks, Raza, that's been really comprehensive. I think that the key thing to tie all this together, is that there clearly is a pipeline of interested investors. We, obviously within our own membership, have a number of LGPS and pension funds and insurers, who are now looking at investing into renewables, into energy infrastructure, and also into the UK. You've mentioned the systems approach that you could take, looking at core technologies and emerging assets, as well as thinking about relationships with developers. If you were to launch a fund in this sector right now, given all the things that we've discussed, could you give a sense of what the key characteristics should look like for an investor? What should they be looking for, what does good look like and what would red flags be for them?

Raza Ali: Yes, absolutely. I think if we are considering a scenario being launched in the renewable infrastructure space today, we imagine that investors would probably focus on the type of technologies being targeted, as well as delivering on the need for higher returns. Importantly, there's a need to be cognisant of the level of the risk being taken.

We recognise that investors are looking for high returns at the moment, but I think there's always a fine balance in achieving those returns whilst mitigating risk.

So, from our perspective, the features that we think that can be added to deliver this combination include a suitable level of diversification across technologies, as well as geography. We think investing on an unlevered basis is important, particularly in the current economic environment, where the cost of debt is high, as well as targeting those greenfield opportunities that I talked about as a means of delivering that upside.

I think I'd also add that earlier, we spoke about wind and solar having a complementary generation profile. So, we think that's a good fit for each other within a portfolio. I would add that, again, we take that unlevered approach to most of our assets, and we think that's a robust model over the long-term. Lastly, as we alluded to earlier, what we do by investing at the very start, or during a construction, we think that that delivers good return enhancements, and this is something that we manage carefully; we've got experience of managing that construction process.

I would also add and reiterate that when targeting this sector, particularly if we're thinking of LGPS investors, and the types of returns that they're targeting, they want to think quite carefully about whether they take developer risk versus what we do, which is make sure that every project is nearly guaranteed to go ahead, because it's got grid, land and planning in place. There's a very different cost of capital if you're taking that risk.

Laasya Shekaran, Pensions for Purpose: The point about leverage is interesting. Can you explain what it means to go in with this unlevelled approach versus perhaps something with more leverage, and why you think about that?

Raza Ali: Yes, absolutely. On our side, we go in with full 100% equity ownership, no leverage. So, what that means is there isn't a set of extra covenants or reporting that our portfolio and asset management teams have to cater for, and that means that we can be much more flexible when it comes to enforcing contracts or deciding the offtake strategy.

It just gives us a lot more flexibility in being able to fulfil those investment requirements for our investors. Also to add, when it comes to leverage, as I'm sure all of your listeners will be aware, the cost of debt at the moment is very high. That's not to say it won't come down, but it does mean that the case is fairly marginal.

Laasya Shekaran, Pensions for Purpose: Thank you, Raza. This has been a really fascinating discussion, and it strikes me that there's a really big opportunity set here in different areas in different regions, where there are a lot of UK investors that are thinking about investing in the UK, investing in private markets, but obviously also investing in a way that supports climate transition. This is a really great opportunity set for them. If there was one thing you wanted listeners to take away from this discussion, what would it be?

Raza Ali: There are many renewable technology options available to investors today. My one recommendation would be for investors to consider carefully the long-term track record of those technologies. This will help them select technologies, such as wind or solar, for example, which have got a robust track record, and that have been tried and tested at scale globally.

Laasya Shekaran, Pensions for Purpose: Yes, that makes a lot of sense. Thank you so much for joining us today. It's been a brilliant discussion. Listeners, if you want to make sure that you never miss an episode, hit the follow button, and remember that you can find us wherever you get your podcasts. Thank you very much, and we'll see you on the next one.