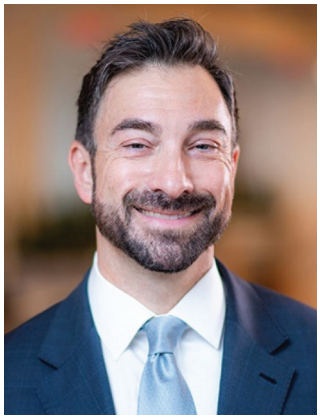
EXPERT Q&A

The energy transition opportunity is now being driven by realism and commercial objectives more than climate philosophy or government policy, says Don Dimitrievich, global head of Nuveen Energy Infrastructure Credit



A pragmatic approach

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Q How is the macroeconomic and geopolitical environment impacting energy markets?

At present, several powerful dynamics are converging to expand the addressable market. The proliferation of AI data centres, the onshoring of supply chains, the broader electrification of the economy and the reindustrialisation trend are collectively driving significant new demand for energy and power.

Layered on top of this structural growth are geopolitical tailwinds stemming from the Iran conflict, which has disrupted roughly 20 percent of the world's liquefied natural gas (LNG) supply and added further urgency and upward pressure to an already tightening market.

Energy markets are responding to these dynamics with an 'all of the above' approach. The scale of the increased demand for power means we need everything that we can get our hands on. That includes low-carbon or zero-carbon emission technologies such as geothermal and nuclear, but we have also seen a resurgence in interest in natural gas-fired generation.

However, while there is a pragmatic acceptance that natural gas has a role to play in meeting growing energy demands, there is also a clear emphasis being placed on reducing reliance on hydrocarbons, not so much for environmental reasons but for reasons of energy security, given recent geopolitical events.

We are already seeing some Asian and European markets taking action as they recognise the vulnerability of overreliance on the Middle East for hydrocarbon supply. South Korea, for example, is exploring access to North American energy, while Germany is looking at Canadian LNG projects.

Finally, the Iran conflict is leading to a renewed focus on renewable energy generation. This is an obvious response to concerns around energy security because it is an energy source entirely within national control and that is clearly more desirable than being exposed to Russian natural gas or LNG, diesel, gasoline and jet fuel from the Middle East.

Q How are you placing your capital as infrastructure debt providers against this backdrop?

We take a pragmatic, commercial view as lenders, so we invest across the entire energy and power ecosystem. That said, responsible investing is deeply embedded in our approach. We see opportunities across the board, given the increased demand for power coupled with renewed focus on energy security. Those trends are converging to create a historic need for investment in critical infrastructure.

We are, of course, looking for the best risk-adjusted returns amid all this opportunity. That means that the vast majority of what we invest in constitutes sustainable infrastructure. If you look at some of the unit economics surrounding energy transition infrastructure in the context of increased hydrocarbon pricing, for example, it is extremely attractive. Energy storage projects too are critical to satisfying increased demand and need for firm power.

There are also new adjacencies becoming very interesting to us when viewed through a pragmatic and commercial lens. Energy efficiency, for example, is an area where we have been very active, which is becoming even more interesting now that power prices are going up. Corporates and industrials are focused on decreasing their operating expenses and protecting their margins.

Energy efficiency is an obvious candidate for achieving those aims and helps reduce carbon emissions at the same time. None of that is being driven by top-down policy initiatives related to climate targets, however. It is all about what makes commercial sense.

Q Are there elements of the energy transition that you would consider to be too far up the risk spectrum for a debt product?

We don't take binary technology risk, and as much as I am a proponent of nuclear energy, we would not invest in that space at this juncture.

There are close to 100 different types of small modular nuclear reactors and while we are seeing the first of those currently being developed in Ontario, Canada, we are not yet in a position to make that leap of faith. I do believe that nuclear is an obvious solution for baseload net zero power, but I think that is more likely to be a mid-2030s opportunity for us.

Geothermal is another area we are following closely, which we believe holds a lot of promise. We have significant sub-surface expertise and industry insight within our team and, like nuclear, that may well be something we explore in the future.

Q How are investors viewing the infrastructure debt energy transition opportunity?

The driving force behind what is happening in the energy sector today is commercial in nature, rather than policy driven. We are electrifying the economy because it is economically savvy to do so.

The same is true of the use of heat pumps. We are seeing an increase in electric vehicle transportation, not because of policy objectives, but because people want to drive electric cars. All those trends are leading to a growing addressable market.

At the same time, we are considerably far along in the economic cycle – at some point there will be a recession. Whether the Iran conflict and some of the stagflation fears that have been created around energy supply will precipitate that recession, no one knows.

Against that backdrop, investors are naturally focusing on defensive asset classes. Infrastructure is highly resilient largely because it is based on contracted offtake, hard collateral, inflation-embedded protections, cashflow visibility and a relative lack of correlation to economic cycles. You need to keep the lights on and heating systems working, even during a recession.

Infrastructure credit, meanwhile, holds a defensive position within the capital structure. That creates a highly compelling proposition for investors in the current environment.

Q Infrastructure debt has attracted a lot of attention over the past few years. How is that impacting competitive dynamics?

Some areas within the energy transition are more competitive than others, such as energy efficiency. Not many of our peers are very active in that space. The infrastructure supply chain build-out relating to onshoring is another case in point. That is an opportunity that is only just emerging, and we are among the first movers.

The third area I would point to would be the circular economy. These are all opportunities that support decarbonisation, but where the underlying project economics make sense without the need for the subsidies or other evidence of the big hand of government, and they are not overly competed.

Q Is there still a danger that actively hostile government policy could derail some investment opportunities?

Some regions and some governments are clearly more proactively supportive of the energy transition, responsible investment and ESG, than others.

However, despite the fact that the current US administration has taken a very different approach to these matters than its predecessor, the rollout of renewables is at an all-time high due to underlying commercial drivers. I expect that trend to continue and, indeed, to accelerate. ■