SPACs, Yieldcos, Bum-Bags, Renewables and PE ? Let's Discuss

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PRACTICES Private Equity, Finance, Private Credit Finance, Renewable Energy

As anyone who owns a bum-bag (or 'fanny pack' to our US friends and colleagues) will tell you, fashion comes back around. This is the case for financial structures as well as '80s clothing, and the resurgence and sudden popularity of special purpose acquisition companies ("**SPACs**") is a good example of this.

SPACs were common place in both the US and European markets pre-2008 as a capital raising alternative to IPOs, but a number of unsuccessful launches in Europe around the time of the Great Financial Crisis ("**GFC**") led to a decline in their use.

SPACs are currently trending as the vehicle of choice in the US with no sign of the boom declining. As a result they have garnered a lot of press recently, which leads to the question "for what purpose are they best used?". It's easy to automatically draw comparisons to other more traditional listed investment vehicles, such as Yieldcos.

Yieldcos were popular in the mid-2010s for the ability to distance their parent company from the risk of holding contracted operating assets directly. A number of these assets could then be bundled together and held by a Yieldco as a form of securitisation. The listing of the Yieldco also provided equity finance for the underlying assets, which is often needed in large, ongoing infrastructure projects. The operating assets held were projects that generated a cash flow over a longer period of time, and the Yieldco would then distribute the 'yield' up to investors, hence the name. The structure was ideal for holding longer-term, low-risk, cash generating projects, such as renewable energy assets.

The craze for Yieldcos soured in 2016 when a large solar power company which used Yieldcos in its structuring went bankrupt. This negative press, and the fact that debt financing offered a cheaper option than equity for such projects, led to a decline in the use of Yieldcos.

The 2016 bankruptcy coincided with a new US administration which paid less interest to the renewable energy sector and which went on to withdraw from the Paris Agreement. Over four years later there is now a new US administration in place again; one which quickly re-joined the Paris Agreement and has made clear that sustainability will be a key policy point. With this rejuvenated support of the renewable energy sector, is it time to find new structures which will facilitate the growth in the market? Could SPACs be the answer?

SPACs are essentially investment shell companies which are listed with the purpose of using the proceeds of such listing to identify and acquire assets which meet certain criteria and within a certain timeframe (usually 12 - 36 months). If assets are not identified and acquired within this timeframe, then the SPAC is wound-up and the funds returned to investors. Whilst the use of SPACs in Europe has declined since the GFC (in part due to the press around unsuccessful launches mentioned above, and because SPACs aren't eligible for listing on the London Stock Exchange's Main Market), SPACs have remained common in the US, and are often used in offshore jurisdictions such as the BVI. Given the success in the US and indeed other parts of Europe (Amsterdam for example), questions are being asked as to whether the LSE should consider making its listing rules more welcoming.

However, with investor pressure driving sponsors to look for sustainable investments, could SPACs step into the space of Yieldcos and offer a route to investment in renewable projects? The answer is probably not.

The G20 has estimated that $6 trillion a year needs to be invested in sustainable finance to reach the Paris Agreement's goal of keeping global warming to below 2?C above pre-industrial levels. To achieve this, it's estimated that 80% of this $6 trillion needs to come from the private sector. Increased regulation is requiring sponsors to look at their portfolios and be transparent about their investments. Regulation is also increasing the risk of certain 'non-green' or 'brown' assets becoming stranded, meaning they are becoming less attractive to sponsors who are looking beyond short-term returns. This results in a high market appetite for sustainable assets and renewables, meaning sponsors don't need to incur the cost of an IPO to find investors.

Whilst SPACs may not be right for larger renewables projects, this does not mean that there aren't advantages to the SPAC structure over and above that typically offered by private equity ("PE") structures particularly when considering alternative asset classes. Over the last few years the amount of dry powder reported by PE firms is incredibly high, and this is partly due to the supply of desirable investments not meeting demand. As stated above, increased regulation, a new climate change aware US administration, and the risk which comes with carbon assets have led to many investors adopting ESG policies, which in turn funds are seeking to adhere to. As with any asset class, supply is limited, and this can lead to funds withholding rather than deploying dry powder whilst they search for the right investment. Due to the structure of a SPAC, the amount of time that the vehicle can sit on this dry powder is limited and any acquisitions made will have to be within well-defined parameters. With SPACs now operating in the same market as PE and chasing the same deals, competition for investments is even higher. This has led many PE firms to launch their own SPACs. Adherence to listing rules will also be attractive to those investors looking for a greater degree of transparency and disclosure. Fees incurred by investing in a SPAC may also potentially be lower as there's no traditional management fee in the same way as there is for PE funds.

In summary, although SPACs share their asset holding and listed nature with Yieldcos, they are unlikely to occupy the same space. With that said, there is huge potential for SPACs within the traditional PE space, and as a result of the tech investing capability there is also real potential for retail investors and the wider economy. SPACs' continued popularity is something to watch out for; we may be dusting off our metaphorical bum-bags this side of the pond yet!