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Rates Aren't Slowing Energy Deals, Sheppard Mullin Atty Says

By **Andrew McIntyre**

Law360 (October 13, 2023, 4:33 PM EDT) -- The real estate market for renewable energy projects has taken less of a hit from rising interest rates than other sectors due to continued investor interest, availability of project sites and a recent federal law, a Sheppard Mullin leader recently told Law360.

Tony Toranto

Tony Toranto, a partner and leader of Sheppard Mullin Richter & Hampton LLP's energy, infrastructure and project finance group, said the 2022 Inflation Reduction Act has helped to accelerate a transition to renewable energy in the U.S.

The Inflation Reduction Act allocated $27 billion for the U.S. Environmental Protection Agency to distribute as grants for renewable energy projects, and as more investors have jumped into the renewable energy space, so too has Sheppard Mullin grown its energy practice over the past decade.

Toranto, who's also a member of the firm's real estate, finance and corporate practice groups, works out of Sheppard Mullin's Del Mar and San Francisco offices in California.

This conversation has been edited for length and clarity.

How have rising interest rates affected projects in the renewable energy space?

Rising interest rates have generally affected everyone who's seeking capital, obviously, because of its effect on the cost of capital. However, I think that renewable energy, while affected, has been one of the industries that has been able to largely continue and grow unaffected. Or at least it hasn't been affected nearly to the degree that other industries have, and I think there are a variety of reasons for that. One of the reasons relates to the high quality and desirability of so many projects. And another relates to the Inflation Reduction Act and a variety of incentives which have helped to continue to accelerate energy transition. But overall, I think that renewable energy has been one of the more robust and resilient industries for purposes of taking interest rate increases in stride and not really seeing those hamper growth and development.

Can you talk more about those incentives? You mentioned the Inflation Reduction Act.

What I could say generally, because the IRA is a very long and detailed statute, and it affects so many different elements of the renewable energy sector, is that the key is just to indicate that the IRA has provided a variety of tax incentives that come in many different forms, which encourage or promote the deployment of a whole range of renewable energy technologies, projects and supporting infrastructure. And that extends from matters that involve solar, wind, energy storage, electric vehicles. The electric grid itself is a very, very lengthy and complex framework.

Can you talk about the investor appetite for deals in the renewable energy space right now, and what you're seeing in terms of transactions?

This is not unrelated to the issue regarding resilience in the face of rising interest rates. I think that the renewable energy sector has been robust in part because of investor appetite for the reasons that I mentioned before. There has been for a long time a class of investors who have been investing in renewable energy and who have been increasing their investment in renewable energy. Those come in the form of equity investors, they come in the form of capital providers that are providing debt, and they come in the form — in the renewable energy sector, also — of tax investors, which are often large banks, but can also be corporations and other participants that have the right tax characteristics.

What's changed more recently is that there has been a continued, as I mentioned before, acceleration of energy transition, and that has taken even more players that were not invested in renewable energy off the sidelines. And so I think more players that might even have been traditional oil and gas investors are now increasing their focus and investment in opportunities involving renewable energy. But it's not by any stretch limited even to conventional energy players. Even investors which have not historically been renewable energy investors have identified renewable energy as an important growth sector. And as a result, I think investor appetite in renewable energy has grown significantly. It's not just more money going to some of the incumbent investors who have already made their presence known in the space. It's also going to new investors and new sources of capital and shifting their focus into the sector.

You mentioned debt providers. I'm wondering what the access to financing looks like for these projects. Are banks pretty willing to lend on these projects?

The short answer is yes. Banks are willing to invest, but there's a lot of nuance there because when we talk about renewable energy as a sector, we're talking about a lot of different technologies. Some of them, very mature. Some of them, very new. We're also talking about a lot of different kinds of projects.

In the more conventional, older energy model, or at least electric power model, it used to be that power was only generated by very large projects. And that's kind of the classic power plant model. But renewable energy has changed that, and as a result, we do continue to have those very large projects, renewable and nonrenewable, but we also have a whole range of distributed generation projects at different sizes. And the reason I say this is that the market for financing is really varied. You could have very large projects with mature technologies like wind, right? Or you could have distributed generation projects that are much smaller projects, but then still have a quite mature technology, like solar. Or you can have a very new project. You can have distributed generation projects with technologies that are at different stages, less mature stages of their growth cycle, too.

Some of those are large, some of those are smaller, but the point is that for lenders, there are different places in the market for different types of lenders, almost like you can divide the market in different sectors to fit different types of lender appetite. So as you would expect, the larger, more mature projects, they tend to be very low risk with very high-quality sponsors. And as a result, they tend to have lower yields from a debt perspective. But there's lots of opportunity for investors or lenders to obtain higher yields by going to some different places in the market where they might have maybe sponsors that are less robust, or technologies or approaches that are newer. And so by a little bit of that trade-off of different flavors of risk, there are lots of different opportunities for investors with different appetites.

I want to talk about your law firm, Sheppard Mullin, as well. Talk to me about the growth of the energy practice at Sheppard Mullin.

Yes, Sheppard Mullin has now over 1,100 lawyers, and when I joined the firm 11 and a half years ago, we did not have much of an energy practice. We had pockets and things that we did as a firm, but I'm very happy and proud to say that 11 and a half years later, our energy infrastructure project finance practice is now a nationally renowned practice of over 95 lawyers, over 65 of whom are full-time, all day, every day energy lawyers.

And our practice is strong across the energy sector, but we're best known perhaps for renewable energy. And within renewables, we are unusual among the leading firms in the sector in that many of the other leading firms in the sector focused their efforts on only project finance. And we do that, and we do it at a very high level. But we also distinguish ourselves by having a very deep and broad project development bench. And our practice covers everything from real estate transactional to land-use to all forms of project agreements, which include power purchase agreements; off-takes; engineering, procurement and construction; operations and maintenance hedges, contracts for differences, and more. It includes mergers and acquisitions, it includes regulatory. It includes project finance on the tax equity and on the debt side. It actually includes intellectual property and litigation. So, a very deep and broad capability.

What are the key trends you're watching in the energy space in the next three months or so?

I think I'll answer your question a little bit differently, Andrew. I don't think the time window is three months. Over too short of a period of time, it's very difficult to probably make anything approaching an accurate prediction. What I see in the near term is continued acceleration and growth pretty consistently across the board in renewable energy. But I would say there will be, over this quarter, an acceleration of project activity where certain projects may have been pushed to the fourth quarter to fully account for some of the benefits and opportunities under the IRA.

I think the broader trend goes far beyond the next three months, and the broader trend is continued acceleration and growth across the range of renewable energy opportunities with some very specific, I think, areas to keep an eye on for even more growth. I think we're going to continue to see even more growth in areas that include energy storage, green hydrogen, offshore wind and electric vehicle charging infrastructure.

--Editing by Haylee Pearl and Covey Son.
