



# Short-term urgent need to find alternative sources of energy, long-term need to move away from fossil fuels

**Chase McWhorter**, Institutional Real Estate, Inc.'s managing director, real estate and infrastructure, recently spoke with **Herman Deetman**, managing director for Infracapital, about how energy transition in Europe has been affected one year into Russia's war in Ukraine. Following is an excerpt of that conversation.

**It has been a year since Russia invaded Ukraine. What has been the impact of the situation on the European infrastructure market?**

The major impact has been on the functioning of the energy markets in Europe. Much of Europe has been dependent for a long time on gas supplies coming from Russia for domestic heating purposes, but also for power generation and industrial use. We have seen significant rises in gas prices, which have accelerated the thinking politically, but also in business, around the need to move away from fossil fuels – in the first instance, from Russian gas, of course, but more importantly, away from gas and fossil fuels in general. Decarbonization has been a big focus politically and in societies across Europe for a long time, but this war and the resulting energy crisis have brought home the need to accelerate that. Investors like us, who focus on energy infrastructure that is sustainable or has the potential to become so, have seen an increase in the number of attractive investment opportunities. These opportunities range from moving domestic heating away from gas to electric heating, to decarbonizing or making industrial processes more energy efficient. These initiatives, which were already relevant before the war, have become even more relevant and more urgent since then, and they require significant investment.

**Is this a short-term or a long-term demand?**

There is a short-term urgent need to find alternative sources of energy to plug the gap of Russian gas that has dropped away. Sadly, part of that is being supplied through coal, and there are a number of coal power plants across Europe that were minimizing operations or were not operating, which have been operating at full capacity for the past few months. That is a great shame, but there is no intention for us to be investing in new coal plants. Then, there is a move to look for diversification in sources of supply of gas. In practice, that has meant a number of liquefied natural gas and floating LNG projects that have been implemented on a relatively short-term basis. They are intended to plug this gap in the supply of Russian gas. We have looked at one or two of those LNG projects, but we really don't think those are ultimately long-term, sustainable solutions. We are big believers that Europe is going to move away from fossil fuels in the medium-to-long term, and as long-term investors, that is where we are placing our bets. We are staying concentrated on looking for investment opportunities that

will help decarbonize the European economy. For Infracapital, those opportunities are less around building renewable-energy generation assets, such as wind and solar, because they are more suited to lower-risk investors. We have been looking at more complicated situations, whether in sustainable heating or electric vehicle charging infrastructure to help accelerate the transition from petrol to electric cars.

**Do your strategies focus on a particular part of Europe?**

We have tended to invest in the United Kingdom and Western Europe, including the Nordics. We have made investments, historically, in a couple of the Eastern European countries as well. Currently, there are no opportunities in those countries in our pipeline, and that is not necessarily because of the war in Ukraine, but more so because those countries are relatively newer E.U. member states. Often their regulatory and legal systems are less developed or developed in such a way that we do not feel comfortable with them. Our big markets have always been, and continue to be, the United Kingdom and Western Europe, and that hasn't really changed from before Russia's war with Ukraine.

**ESG is increasingly important to both managers and investors. Which European market is leading in this space?**

Being Dutch, I can say that the Netherlands is one of the leaders in ESG. We have been looking at ESG and, particularly, the environmental impact of our portfolio companies for quite a number of years. We started to report on this long before ESG became the norm, and we pride ourselves on having been early providers of dedicated environmental impact reports. These days, our investors require more detailed quantitative information on our investments – and rightfully so. We have invested in systems to provide that. Particularly important are the carbon emissions that come from our portfolio companies, and measuring those emissions is not always completely straightforward. We've been working with our management teams to make sure we have the best reflection of that, but equally important is creating value through transitioning away from carbon-intensive parts of the business. A good example of that is a business we own in the Netherlands called Inland Terminals Group. It is a container terminal operator that moves containers from the big ports of Rotterdam and Antwerp to inland terminals over rivers and canals using barges. Those barges today are mostly using fuel oil, but we are investing in transitioning those barges to be able to move using batteries. We are installing battery-charging stations at our terminals, and batteries can then be exchanged as containers get loaded and offloaded at the terminal. The customers of Inland Terminals Group are increasingly willing to pay a premium to achieve a greener logistics chain. It is a win-win for us.

When people talk about ESG, they tend to focus on the E, the environmental impact. At Infracapital, we are very much focused on the social and governance impacts of our portfolio companies, too. We are big believers in creating opportunities for younger people from all backgrounds to be part of the infrastructure industry, whether that is working at Infracapital or for our portfolio companies. We really try to make sure that is evident in the way we recruit and train people.

**Decarbonization is a huge challenge facing the infrastructure sector. Can you give an example of how one of your assets is facing up to it?**

Hybrid barges are certainly one example. Another strong business we own in the United Kingdom is called Last Mile Infrastructure. It installs the electric, gas and water connections for new buildings. The business is very much linked to the need to continue to connect newly constructed buildings to the nation's infrastructure. Meanwhile, over time, people will need to replace gas with other forms of heating, in line with legislation, so LMI has entered into a joint venture to install electric heat pumps in new buildings. This is still at quite an early stage in the United Kingdom. Not only do we see it as a very interesting growth market, but we also regard it as our responsibility as a utility provider to make sure sustainable heating is part of our offering. That is another example of a portfolio company taking on the challenge of moving away from fossil fuels.

**How would you describe Infracapital's key differentiators?**

We are a mid-market player, which gives us a certain agility in terms of the geographic locations and sectors we consider. That has been a key advantage and differentiator because we have been very good at identifying new areas of infrastructure, and not because we are redefining what infrastructure is, as some managers have been doing. We very much stick to infrastructure as an essential and resilient asset class, but we see either technical or legislative developments that are increasing the need for infrastructure investment in certain sectors, and we have been good at identifying those sectors and being an early mover by deploying capital into them. The United Kingdom, for example, mandated the installation of smart meters in all homes across the country, starting in 2016. A smart meter is basically a way to make households more aware of the energy they are using so they can be more economical in their use. When we saw that legislation coming, clearly requiring a huge investment across all U.K. households, we invested in a U.K. smart-metering business, and we grew it significantly. Another example of that is our business Eteck in the Netherlands. In 2015, the Dutch government prohibited the use of gas for new buildings, which

we saw as a huge growth-driver for alternative forms of heating. Eteck provides sustainable, electric-thermal heat systems to new buildings. Electric vehicle charging is another area where we were an early mover by acquiring the market leader in Norway. Norway is the most advanced country, globally, in terms of electric vehicle adoption rates; about 80 percent of new cars are either electric or plug-in hybrids. We entered that market quite a few years before other infrastructure investors really caught on to this as a key area of growth, and so we took advantage of being nimble and able to target smaller deals. Often, new sectors start relatively small and then require the deployment of quite a significant amount of capital during the time of our holding period.

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**Do you think the shift in the macro environment will lead to any new opportunities?**

It will not necessarily lead to new areas of investment, but it will accelerate investments to establish energy independence and to decarbonize. The government budget deficits were already quite stretched before the pandemic, but they are becoming more stretched post-COVID, and in the current economic climate, that means an even greater role for the private sector to play in plugging that gap in infrastructure investment. We are very excited about the pipeline of opportunities we are seeing at the moment. The quality of the projects and their return profile are stronger than they have ever been. In that sense, we do think that the current macro environment, despite the fact that it poses some short-term challenges for all of us, ultimately is favorable for infrastructure as an asset class. Inflation, of course, is a big topic, and most of the assets we look at have inflation protection, either directly or indirectly. That is something our investors are valuing greatly. We always said infrastructure was a resilient asset class, but now is really the time we are proving it.

**CONTRIBUTOR**



**Herman Deetman**  
**Managing Director, Infracapital**  
**[Infracapital.Investor.Relations@infracapital.co.uk](mailto:Infracapital.Investor.Relations@infracapital.co.uk)**

**CORPORATE OVERVIEW**

**Infracapital** invests in, builds and manages a diverse range of essential infrastructure to meet the evolving needs of society and support sustainable long-term economic growth. Infracapital takes an active role in all of its investments to ensure they are adaptable and resilient, while working closely with local communities. Infracapital has raised and managed more than £6.5 billion (\$9.02 billion) across six funds since 2001.

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