THE JOURNAL FOR ASSET FINANCE

LEASINGLIFE

October 2015 Vol 21 No 265

www.leasinglife.com

Green leasing

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The new dynamics of clean technology finance, and the 'power' struggle

While the renewable energy finance market is expected to shrink, lessors are observing a boost in demand for financing other clean technologies. **Sotiris Kanaris** reports

Over the past decade, government subsidies have triggered greater investment in renewable energy, while companies' policies around corporate social responsibility and energy cost reduction have increased the demand for clean technology equipment. A number of European lessors have entered the clean technology finance market and created dedicated teams, providing billions of euros to the sector.

ING Commercial Banking increased its volume of financing by 7% year-on-year for sustainable clients and projects in the first half year of 2015, reaching over €20.9bn.

"This is in line with ING's target to grow its financing of sustainable transitions and includes loans to renewable energy schemes, environmental outperformers and other sustainability projects," says Leonie Schreve, ING global head of sustainable finance.

The wide spectrum of clean technologies and their different life cycles allows lessors to offer a range of propositions to customers. In addition, it acts like a safety net to maintain business when demand for certain products plunges.

Renewable energy generation

Since the early 2000s, the European renewable energy market has reported a continuous upward trend in total power generation. According to Eurostat, renewable energy's share of the total energy generated in the EU increased from 8% to 15% in the decade to 2013.

This rise was influenced by EU member states' efforts to achieve national and international renewable energy targets. Subsidies have skyrocketed demand, primarily for photovoltaic (PV) equipment, but also for wind turbines and biomass technologies.

As the demand for renewable energy equipment increased, so did the demand for financing them. Senior director of Lombard's green energy team Hiten Sonpal says that at the beginning asset financiers and lessors were not confident in financing this type of equipment and as a result companies used other finance routes.

Sonpal says: "The first finance option for companies was cash, using their own liquid assets and benefits from government subsidies and savings. The second option was to go to the bank and raise cash against tangible securities, like land or buildings. However, this didn't help the company as it tied up all securities, hampering them if they wanted to purchase another piece of land or buildings. The third option was to go to an equity funder or venture capitalist, but they charge extremely high double-digit margins because of the risk. The final route was mainly taken for the larger projects."

As technologies developed and government subsidies were introduced, lessors identified a buoyant market in which to operate.

Sonpal describes the levels of business Lombard carried out in the UK right after the introduction of tariffs. "The first wave of technologies that took off was solar PV, when the feed-in tariff was introduced in May 2010," he says. "Some of the market captured the opportunity quickly and invested heavily in solar in the early days. We provided over £150m (€204m) of funding in the first six to nine months. The same scenario was witnessed when the renewable heat incentive was launched; we had a huge influx of biomass transactions."

The dependency of the renewable energy market on government subsidies became evident after a number of governments – including Spain, Italy and Germany – decided to reduce feed-in tariffs.

Bruce Trachtenberg, vice-president and general manager, global clean technology at DLL says: "What we've seen is that renewable financing is most attractive when there are government incentives offered. We're seeing that as the relevant government incentives change, the market changes quickly with them."

Bruce Trachtenberg, DLL


Richard Baker, Siemens Financial Services

In the UK, proposals to reduce feed-in tariff subsidies by 87% have been detailed in a Department of Energy and Climate Change consultation document released in August. The plan is to reduce the tariff for small-scale installations from 12.47p per kilowatt hour to 1.63p per kilowatt hour from January 2016.

"Following the UK government's recent decision to reduce the feed-in tariffs, there has been an increase in the rate of solar panel installations, as businesses seek to benefit from the current incentives. There's an expectation that the activity will fall once those feed-in tariffs are reduced," says Trachtenberg.

The view that the market will shrink because of the fall in tariffs is shared by Neil Davies, chief executive officer of the leasing and rentals division at Close Brothers.

"The market was growing and will now cease to grow; in fact it will reduce over the next few years. Reducing the tariff makes the market more competitive, but reducing it too fast too quickly reduces the market significantly," says Davies.

Apart from government subsidies, price is another factor which affects demand for renewable energy finance.

Trachtenberg explains: "As the costs of these technologies come down, it improves the value proposition and reduces the market's reliance on government incentives."

Richard Baker, sales manager of the energy efficiency financing scheme at Siemens Financial Services (SMS), highlights that renewable energy finance is also affected by the trends in fossil fuels and particularly oil prices.

Renewable energy is being financed both through project finance structures as well as traditional financing. Trachtenberg says that as the equipment becomes more efficient and affordable, the financing terms can become shorter and traditional financing structures will be used more frequently than project finance.

Apart from financing equipment, the market for refinancing renewable energy projects grew. According to Lombard, since the end of last year this is the biggest growth area of its clean technology business.

Sonpal says: "As projects mature and we are more comfortable with larger projects, we became more creative on how we structure transactions. A lot of business with big projects are asking us for an asset finance proposition. For those who followed the cash route, they can refinance with our product and release cash to invest back into the business. Those who initially used finance from a bank, use refinancing to release the security, while those businesses which obtained finance from an equity funder or venture capital, can use refinancing to reduce the interest cost and term of the debt."

Sonpal believes that it's more secure for an asset financier to refinance and he expects this product to become more popular in the future.

"If anything's going to go wrong with a renewable project, it will go wrong in the first six to 12 months. So if you are funding an asset that's 12 months old, all the issues have been ironed out and you have the asset that is going to run for the next 10 to 20 years. I see the refinance market as being a huge growth area," he explains.

Competition in renewable energy finance has increased with the number of players entering the market. Crowdfunding and peer-to-peer platforms focusing on renewable energy have been created around Europe, and in the UK some challenger banks have entered the market.

Sonpal believes the crowdfunding and peer-to-peer platforms are not competitors and that they are "fantastic" for asset financiers. Apart from financing the construction side of a project, the high rates they charge can bring customers seeking refinancing to asset finance companies.

"They are very good for us, because they take all of the risk on the construction side of the projects, but charge extremely high rates," says Sonpal. "I went to see a client for an anaerobic digestion plant which cost £4m, and the funding was done by a fintech company with interest rates between 12% and 15%. The project has been going on for over a year now, and the client would like to refinance the debt with a senior debt funder like ourselves and reduce the interest cost to a single-digit margin in order to help with the cash flows."

According to Trachtenberg at DLL, the greatest challenge for lessors is to stay close to the shifting technologies, changing government incentives, the evolving customer needs in relation to balance sheet and other financing requirements in every country.

The changing government incentives on renewable energy will be a challenge that lessors will face in the near future. Davies believes that the change could also alter the type of investors in the industry.

At Close Brothers Davies says: "All existing assets will continue to receive subsidies; the question is how the dynamics in the market will change in the post-subsidy period, if indeed no new subsidy replaces it.

"We know that a number of sites we financed would be economic even without subsidy, as they would pay out but with different returns than they do now. As a result, you may end up with a different type of investor going into the market and a significant part of the income based on electricity prices. Electricity prices over the last few years have been low; were electricity prices to increase then these types of investments will become more viable."

Baker at SMS highlights the significant role of "affordable" financing for the future of the industry: "While government incentives have been playing a role in facilitating green energy investments, the long-term development of the energy efficiency and clean energy markets will have to be supported by the availability of affordable financing."

Energy efficiency

Demand for energy efficiency technology has risen in recent years, and as a result lessors are offering a plethora of options for companies to reduce their energy bills.

Energy efficiency projects include combined heat and power, HVAC (heating, ventilating and air conditioning), building controls and lighting.

At DLL Trachtenberg says: "The demand has increased a lot in recent years. It is a very robust market. Customers are realising that before they move forward with a renewable project, doing an energy efficiency project makes a lot of sense.

"If you think about it, why install a 1MW solar PV array, if you can first reduce your energy needs through an energy efficiency project to a level so that an array supporting 700-800kW would be sufficient?"

Both Lombard's Sonpal and Trachtenberg believe that LED lighting is a strong and growing market. Sonpal explains that, despite the lack of subsidies, it makes economic sense for companies to install LED lights. He says: "LED is a great way of reducing your energy cost and having the payback in 12 to 14 months, depending on your electricity requirement. The key factor that people have always missed out on with LED is the enhanced capital allowances you get for LED lighting, which is 100%. This makes it attractive for any business."

A lack of extensive knowledge on these

technologies and customising finance packages can pose a challenge for lessors operating in the energy efficiency finance segment, according to SMS's Baker.

He says: "This market segment is challenging for lessors without sufficient technology know-how and market knowledge. Without a comprehensive understanding of equipment application and its useful life cycle, lessors might struggle to gauge the energy generated through the acquired technology and potential financial savings, both important investment criteria for end-clients.

"In addition, crafting customised financing arrangements catering for individual circumstances, such as desired outcomes, certain restrictions related to large-scale projects, and specific requirements from equipment suppliers, could also be a complex matter for lessors less familiar with the market."

The need for in-depth knowledge is affecting competition in the market, as some lessors decide not to enter. Trachtenberg says: "There's competition, but what I've found is that these types of technologies are often not well understood by the traditional banking and lessor community. For example, certain energy-efficiency technologies are considered fixed assets depending on the country where they are installed, or even by their application within a particular country. As a result there are financiers that shy away from financing such equipment."

Siemens Financial Services characterises the potential of electricity efficiency (the proportion of current electricity consumption that could be saved if more electricity-efficient equipment currently available on the market were installed) in global manufacturing as "significant", and highlights that it remains "untapped."

An SFS survey conducted among the global top 20 industrial equipment manufacturers found potential energy savings ranging from 14% to 20%. Scandinavian countries have the highest industrial electricity-efficiency potential in Europe, at 15.6%, followed by France (15.1%), Germany (14.5%), Spain (14.2%) and UK (14.2%).

Brian Foster, head of industry finance at SFS, says: "Investing in electricity-efficiency technologies not only helps cut energy bills, manufacturing costs and carbon emissions. New equipment often brings productivity and capacity improvements as an added bonus, improving business performance and competitiveness."

Waste management and recycling

Waste management and recycling equipment finance is a market segment where a lower number of lessors operate compared to renewable energy and energy efficiency.

Assets usually financed are crushers, screeners, rehandlers, shredders, excavators, loading shovels, refuse-derived fuel plants, recycling processing equipment, separation equipment and composting equipment.

Steven Gee, director at Close Brothers Asset Finance, says the industry is "fast-moving" and witnesses changes of laws and regulations on a regular basis. Recent changes in levies imposed by the UK government have affected the market, but they didn't stop the growth of the market.

Gee says: "The recycling industry is growing quickly. There have been a few issues over the past two to three years, mainly caused by the government increasing some of the levies on the industry. The change caused a lot of cash flow problems for some businesses, which had to change business model overnight. There has been a degree of pain for many companies, but are now coming out of that."

Another issue faced by the industry is the difficulty in obtaining insurance, because of the high fire risk in household waste. A number of fires around the UK made it hard and expensive for related businesses to get an insurance contract.

"There's a clash between the government encouraging people to recycle everything and the people recycling it having difficulties obtaining things like insurance," says Gee.

Despite the increase in levies and insurance costs, many companies decided to enter the UK market.

"There's a growing number of entrants in the market. Businesses have been set up with a contract, typically from the local council, to collect household waste and recycle it," adds Gee.

The high initial fixed costs for setting up a recycling plant and the fact that the equipment is expensive, presents an opportunity for asset financiers to serve this sector.

Gee says: "A company could spend anywhere between £250,000 and £2m to set up a recycling plant. Not many start-ups would have that kind of capital to hand; therefore there's an opportunity for asset finance."

He believes the asset finance industry is more suitable to serve the industry than other finance companies.

Gee explains: "I wouldn't have thought a bank would lend a million pounds to a new recycling business without some secondary security offered. Unless there were some significant shareholders guaranteeing it, I couldn't imagine banks having much appetite for lending specifically for equipment. That's where we are different; we rely on the assets."

Gee expects the market to grow further in future, but also to become more regulated. He says: "I would suggest it will continue to grow because the government has


Carsten Kwirandt, Alphabet International

commitments to keep towards the recycling of waste.

"The big drive is away from landfill and that encourages the growth of the recycling business. The government forecasts that the drop in the amount of landfill waste will continue in the future. The recycling industry is going to grow further and more businesses will enter the market. However, I think that, as it continues to grow, it will get more regulated as well."

The future looks bright for lessors operating in the industry across Europe as a study predicts the continent's recycling industry is poised for a period of significant growth.

A market study by German-based consulting group Ecoprog, *The European Market for Plastic Sorting and Recycling*, predicts up to 300 new recycling plants, with an estimated capacity of 5.2 million tonnes to be commissioned over the next decade.

The main growth driver is expected to be the EU waste framework directive, which requires member states to reuse or recycle at least 50% of certain household wastes by 2020. Almost no EU member state has reached the target, and many are at risk of missing it.

'Green' fleet

Alternate fuel vehicles (AFVs) are those that do not run on traditional petroleum fuels, such as hybrids, plug-in hybrids and electric cars. Over the past few years, manufacturers have invested heavily in the research and development of AFVs, and launched a number of models. There are currently 27


Tim Albertsen, ALD Automotive

electric cars and nine electric vans on the UK market.

Speaking about the increased range of electric cars, Carsten Kwirandt, Alphabet International's head of marketing and business development, says: "The most sustainable trend that I see in AFVs is the one for electric vehicles. The number of electric vehicles has increased compared to three years ago. We now see that more OEMs are investing into that area, so it's not only the front-runners Tesla and BMW, but also Volkswagen, Nissan and Renault. All the big non-premium car manufacturers are following up, having at least one model in their product range that is electrified."

As the range of models of AFVs broadened and their technology improved, companies are increasingly choosing such vehicles for their fleet. According to the Society of Motor Manufacturers and Traders (SMMT), there were 19,474 fleet AFVs registered in the first seven months of 2015 in the UK, 75% higher than the same period in 2014.

In the figures SMMT provides to *Leasing Life*, a plug-in hybrid was the most popular AFV for fleet in the first half of the year. The Mitsubishi Outlander sold 5,265 units, followed by the electric vehicle Nissan Leaf with 1,129 units sold.

The strong demand for plug-in hybrids is highlighted by deputy CEO at ALD Automotive, Tim Albertsen, who observes a considerable increase in popularity of these vehicles over the last 12 months.

Electric vehicles are also popular for fleet, although their demand varies from country to country. Kwirandt, who planned and oversaw the 2013 international roll-out of Alphabet's mobility product AlphaElectric says: "We are extremely satisfied with the sales volumes of our electric vehicles, although they vary from market to market depending on the fiscal regime.

"There are markets where there are higher subsidies for charging infrastructure for electric vehicles, while there are others without any subsidies. For electric vehicles in general – not only for fleet – Norway, the Netherlands and the UK are outstanding markets."

Poppy Welch, head of Go Ultra Low – a campaign promoting AFVs funded by the UK government and seven car manufacturers – explains the reasons behind many companies' decision to use electric vehicles in their fleet.

"Companies can see that over the whole life of the car they can make quite significant savings on fuel costs," Welch says. "I imagine for those companies that have started to take on electric cars that is one of the main drivers, as wells as tax benefits, the lack of congestion charges, and the 20-40% reduction in service maintenance and repair costs."

As electric vehicles are an environmentally friendly technology, governments have been trying to promote their use. The current UK plug-in grant provides up to £5,000 off the purchase price for an electric car, for example.

At ALD, Albertsen believes that government incentives are essential to create demand for electric cars for fleet. He says: "The market for electric vehicles in Norway is taking off very well, because electric vehicle users do not pay company tax, they can drive in bus lanes and can park free in Oslo. These incentives are central, especially for pure electrics. If you don't have incentives like that, pure electrics are going nowhere."

An obstacle to the demand for electric vehicles is their autonomy, as they have a limited range. "I would say that most people do not want an electric car, even if 90% of their trips are only 30-40km long. They now want cars with autonomy of 100-150km," says Albertsen.

The small network of recharging stations also poses a challenge for fleet lessors and captives to promote electric vehicles, according to Kwirandt. He adds: "This is one of the reasons behind an American car manufacturer's decision to set up a network of super chargers across Europe, to promote long-distance travels with electric vehicles."

Another barrier which makes AFVs less attractive than internal combustion engine (ICE) cars for fleet is price. "Whenever a new technology enters the market, price is an obstacle to demand," says Kwirandt. "The price of electric vehicles is high because the development cost is extremely high. I believe the cost of EVs, especially the cost of batteries, needs to be lower in order to be more competitive with ICE cars."

Most captives and fleet lessors have AFV propositions, with competition in the market increasing over time.

Albertsen says: "We compete more or less on the same terms. I think all lessors have a similar view on the future of the market, residual values and maintenance. As a result we meet each other in the market with similar offers and we compete as we do with ICE cars. In terms of full electrics, the market is still driven by manufacturers, because it's their technology and they have to prove it is good enough to take the risk on residual values for these cars."

Welch says that the issue of charging points is slowly being resolved. According to Go Ultra Low, there are currently approximately 9,000 publicly accessible charging points around the UK, a higher number than petrol stations.

The need for governments to invest in this sector is highlighted by Kwirandt who says: "I think there's an obligation for governments around the world to further promote electric vehicles and charging infrastructure, to allow e-mobility to develop on a broader scale.

"Imagine the level of emissions that could be saved every day if all the cars on the road taking a 30km trip were EVs – this would be tremendous. Governments have a duty to fulfil to promote e-mobility better and further, maybe through leveraging taxes or offering more public charging facilities or even by supporting the installation of private charging units at people's houses."

The UK government targets that by 2040 all vehicles sold in the market will be AFVs, and by 2050 every vehicle on the road will be alternatively fuelled. "These are ambitious targets, but there's significant funding in place to achieve that," says Welch.

Such government incentives show that the fleet market for AFVs will grow in the future. "It is a growing market and the speed of that development will depend to some extend on the manufacturers' offerings in terms of autonomy of the vehicles, the subsidies from the government and the development of the correct infrastructure," says Albertsen.

Hydrogen-powered cars will be the new type of AFV that manufacturers will be pushing in the market. Last month, Toyota presented its first hydrogen-powered car, Mirai, at the Frankfurt Auto Show IAA, while Honda will soon unveil its own model.

Albertsen believes that once manufacturers manage to stabilise the technology for hydrogen cars, it will be the type of vehicle with the "brightest future". ■