Why Islamic finance and solar are a natural fit

Future solar finance | Ahead of the Solar Finance & Investment Asia Conference in Singapore, Dr M. Rusydi of SGI Mitabu tells John Parnell how solar could tap into the potentially enormous investment opportunities offered by Islamic finance

As with any new solar market, and so many other things in life, money can prove to be the limiting factor. Until investors and lenders are comfortable the brakes are applied and the potential for PV to make an impact is limited.

In this scenario many parts of Asia suffer more than other regions. No one will lose any sleep over the speed at which a remote mining operation in South America is able to secure its supply, but the need for new electricity generation in blossoming economies like Thailand, Indonesia and the Philippines is more pressing. In many emerging markets, failure to invest in adequate energy infrastructure has tempered economic growth.

South Africa's government-backed procurement programme helped get early projects, and investors, into solar. Chile has benefitted from the long-term contracts projects have signed with high-calibre off-takers. Both models offer lessons to governments in Asia but there is a less established opportunity to source finance for projects that have been largely overlooked so far; given the demographics of the region, it could well make a major contribution to solar power development.

Islamic finance could prove to be a perfect fit in a part of the world that includes the country with the world's largest population of Muslims – Indonesia. There are actually three times more Muslims in south and Southeast Asia than there are in the Middle East.

It is crucial straight out the gate to dispel a few myths. You don't have to be Muslim to partake in Islamic finance or even to offer it. The UK government offered its own Sukuk – the equivalent of a bond – becoming the first to be backed by a non-Muslim government. (The £200 million bond UK release was 11 times oversubscribed.)

Dr M. Rusydi is the director of SGI Mitabu Australia, an investment and development firm behind a 50MW solar project in Indonesia. Rusydi – who will be a speaker at Solar Media's Solar Finance & Investment Asia event in Singapore at the end of June – explains the key differences for solar industry professionals to be aware of.

"The difference with conventional finance is the fact that they don't use interest rates. Islamic finance relies on the underlying projects. Instead of interest rates there is a concept of profit sharing," he says. "The project and the profits from it are linked directly to the financing process. So whatever profits are generated are shared among the parties who invested, as is the risk."

In the case of the UK government's Sukuk, the asset underlying the investment was rental revenue generated from Her Majesty's Government property portfolio. In the case of solar, the asset is the installation and an associated long-term contract to supply electricity. Rusydi argues that the nature of these contracts makes solar a great candidate for Sukuks.

"By their nature renewable projects are long term, the PPA could last for 20 years meaning the project itself and the contract to supply the electricity can be quantified as an asset," he explains. "This creates a very good opportunity to structure this financing using Islamic finance. We are also talking about clean energy; it supports a better environment and that puts renewable energy among the top tier of projects for investment under Islamic finance."

This final point refers to some of the less quantifiable features of Islamic finance. There is an enshrined prerogative to invest in "wholesome" projects and those which benefit the welfare of local communities. In some cases this is clear cut – businesses involved in gambling or the sale of alcohol are excluded, for example. But defining "wholesome" is not always straightforward. For renewables the argument that these criteria can be met is much stronger, especially for solar given that it can be built at scales that directly benefit locals and is not merely the preserve of multinational corporations.

At the same time, Rusydi says, the collaborative nature of Sukuks makes them a great fit for solar. "People bring their contribution to the table, the person who had the idea, people that can bring skills or contribute the business model and investors can come to the table with money as their contribution. So it's like a collaboration between different parties but the bottom line is that everyone will share the profits accordingly," he says.

This model is being borne out on his own solar projects with partners from the solar industry keen to translate work as contractors or suppliers to the power plants, into an investment in the Sukuk consortium that owns them.

"The EPCs want to be partners rather than just provide a service...they can also invest in the project if possible so they are more than just an EPC. They can see the potential of sharing the profit. This is very interesting because it gives them an opportunity to go beyond operating as a standard EPC and can co-own the plant and share the resulting profits," Rusydi says. He argues that this is a good strategy for firms to acquire some longer-term revenue, even if they don't have the scale to invest in projects outright in the way that the industry's larger players are doing through yieldcos and other forms of conventional finance.

So far he says the reaction from the industry has been very good, with Sukuk's often proving a smaller administrative burden given their independence from the vagaries of conventional market dynamics and of course, interest rates.

Without the presence of traditional banks, the issue of bankabil-

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The 4th Solar Finance & Investment Conference moves to Singapore at the end of June to bring together Asian developers, financiers and investors to drive forward deployment of rooftop and ground mount solar.

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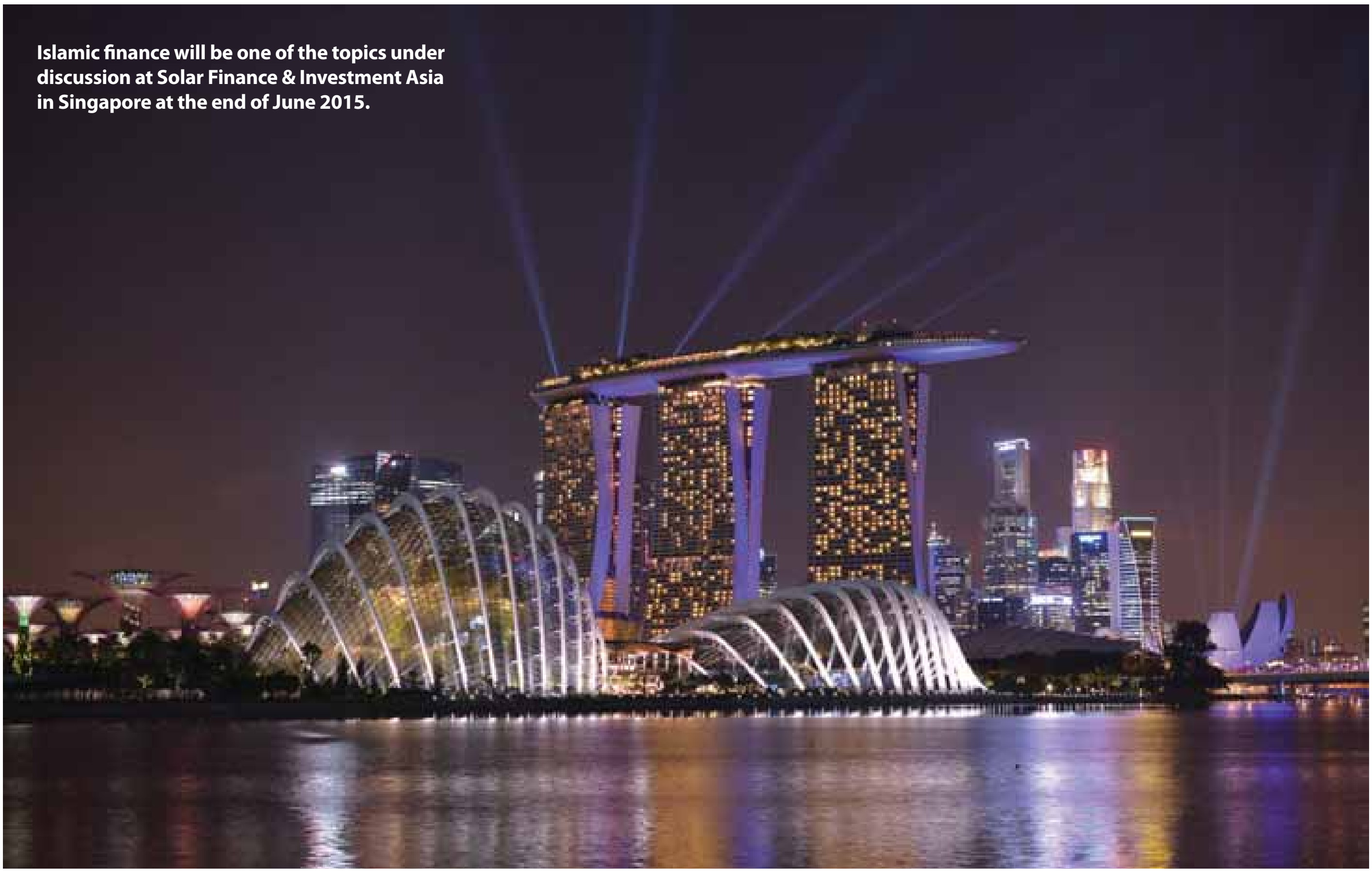

Islamic finance will be one of the topics under discussion at Solar Finance & Investment Asia in Singapore at the end of June 2015.

Source: Nicolas Lannuzel/Flickr.

ity also changes. Instead of products and contractors being scrutinised by a lender with a fairly rigid set of criteria, the group offering the Sukuk assesses the credibility of suppliers. With nothing to gain from poor choices being made, all the investors are as motivated as each other to see the project succeed.

Much of the recent success of solar has been attributed to the maturity of the sector and the finance world's increasing comfort with solar as an asset class. With that in mind, the introduction of a new source of financing could be viewed with some scepticism. The sector has worked hard to achieve securitisation of lease contracts, to make ultra-conservative institutional investors comfortable with the technology and even persuaded high street investors to back solar.

The benefits Rusydi describes are very real but what is the scale of this seemingly niche opportunity in comparison to traditional finance and can it really compete?

The ratings agency Standard and Poors estimated that US$100-115 billion of Sukuks will be issued in 2015. This figure has plenty of scope to ramp up in the future.

"With Islamic finance in general we are talking about a global market with excess liquidity of US$1.5 trillion. This excess liquidity is very large; it's as large as the combination of a number of sovereign funds. It's no longer a niche market, it's a huge market, and infrastructure projects in Asia are currently at close to US$1 trillion. Islamic finance has to be channelled into real projects and infrastructure projects, especially in Asia, offer a very good opportunity for Islamic finance to play a role," he says.

There is little question over the scale of the financing available; investors in the Gulf have shown their appetite for renewable projects at home and abroad. A pipeline of projects backed by Islamic finance would surely be very appealing to the sovereign wealth funds of Abu Dhabi and Doha.

On the topic of competitive returns Rusydi is a little more coy, pointing instead to other advantages of the model.

"The selling point is slightly different, the way Islamic finance approaches the creation of assets and the way investors become partners is different and can overcome some of the barriers in conventional consortium funding that force a number of banks to finance one project. It allows big infrastructure projects to get funding in this part of the world where the parties come together into one special purpose vehicle. The selling point is different."

The Solar Finance & Investment Asia Conference in Singapore on 29-30 June 2015 will explore Islamic financing and conventional funding in the Asian solar market in more depth. Confirmed speakers include Credit Suisse, SPCG, Armstrong Asset Management and the Economic Development Board of Singapore. Further details are available at financeasia.solarenergyevents.com