

Brian Jones

Episode 226: Renewable Returns: Windmill Capital on Driving Change with Clean Energy Investments



GUEST Q & A

Stewart Foley: Welcome to another edition of the InsuranceAUM.com podcast. My name is Stewart Foley, I'll be your host. Thanks for joining us. It's great to have you. I want to give a huge shout-out to the Bermuda insurance investment community. I just got back from Nathalie Rushe's event, Rushe Capital in Bermuda, and saw a lot of friends. I saw just a whole bunch of Bermuda investors.

I also saw Stuart Hrehoruk, who shares the first name with me and an old friend there. So, I want to say big shout out to those folks. And everybody at that event was just fantastic. And it's interesting because when we were... I was at a lunch table and the topic of renewable infrastructure and clean energy was brought up. And it just happens to be that we have a terrific podcast for you today on exactly that topic. And I'm joined today by Brian Jones, managing partner of Windmill Capital Management. And you're also the founder, Brian, and I want to talk about that. So, welcome and thanks for being on.

Brian Jones: Yes, thank you, Stewart. Appreciate the opportunity to talk and am very excited to share some perspectives on renewables.

Stewart Foley: That's perfect. So, we're going to run you through the same gauntlet as everybody else. So, where did you grow up? What was your first job? Not the fancy one either. And what makes insurance asset management so cool?

Brian Jones: So, I grew up right here in my current hometown, Menlo Park, California. And went to university, spent 15 years in San Francisco, and then after I had kids, moved back here. And they went to the same middle school and elementary school that I went to, so kind of cool. Not a lot of people get that opportunity to come back to their roots.

My first job was a paper route. I think probably a lot of folks in my generation, that would've been their first job. And we were an afternoon paper, so I'd come home from school, fold papers to go out deliver them. And it was a customer service-oriented type of job, for sure. And I remember earning a trip to Disneyland by selling newspaper subscriptions. So, it was a good start for a long career.

Stewart Foley: Success at raising capital at an early age, Brian. That's how I'd refer to that.

Brian Jones: Yeah, precisely.

Stewart Foley: Exactly.

Brian Jones: I think at the time, it was \$6 a month or \$4 a month or something like that. Now, you don't see kids delivering newspapers anymore. Adults deliver them from a car.

Stewart Foley: Yeah, absolutely. And what makes insurance asset management so cool?

Brian Jones: For us, it's just so... the interests and objectives of insurance investors so closely align with energy. It's an income-oriented investment class; and in renewables in particular, because the broader objectives of the insurance companies as far as measuring and monitoring risk, these are investments that... some of our biggest risks are now climate and weather-related.

And so, this is an opportunity not only to earn economic return, but also to try to push some of that tide back. And hey, the insurance companies are large investors. The energy transition is a multi-trillion dollar decades-long opportunity. So, we're early innings, but it's a perfect time for insurance companies to be looking at and getting active in the space.

Stewart Foley: And it's often the case that when you're early to an investment to an asset class, the best opportunities. So, I've always thought, just personally, that insurance companies have a unique opportunity to take their asset side of their balance sheet and have a positive impact on the liability side of their balance sheet, because ultimately at the end of the day, they'd like to have less claims than more, and weather is certainly a source of more claims.

So, I agree with you wholeheartedly that I think that you align nicely with the insurance industry's larger objectives. But I want to start with: you founded Windmill Capital Management. What caused you to do that? And just give us a little of the history of Windmill. Before we get going too far into the asset class, I just want to start there. Because as a fellow founder, I love having founders on because I'm like, "Were you scared to death too," is my overarching question.

Brian Jones: Yeah. Being a company founder is such an interesting combination of determined conviction and terror.

Stewart Foley: Sorry. Actually, that's a first. I've never started on a podcast in my life. That was hilarious. That is the truth too.

Brian Jones: Yeah, yeah. There's so many things that you just can't know in going into something like this, but it started with conviction. And I worked on an asset management platform, had a number of jobs, including taking a couple of companies public off of that platform and chief financial officer of some public companies as well as capital raising and structuring new investments.

And we spent a lot of time looking at renewables and how to invest in the space. And that platform wasn't able to make those investments, but it built for me a strong conviction in the need and the benefits of renewable energy. And I come from an infrastructure hard asset, real estate background, and it was just the benefits for property owners, for business owners, for investors, both sides of the equation, customers and investors.

The benefits of doing this and the need, it's hard to ignore the climate aspects, and certainly energy is a big driver in climate change. So, that part of it was easy, and then I figured the rest of it would work itself out. And so, we really approach every day with a learning attitude. The marketplace is changing rapidly.

We try to stick to what we know best, and that's not the engineering side or the technology side. We try to stick with stuff that we know works. We focus on cash flow, which, I think, is a way to protect downside. And so, we come with it with humility. We come with it from a perspective that we are servants of and custodians of our partners, our investor partners' capital, and we take that duty very seriously.

Stewart Foley: I'm looking at my notes here, and I've got since 2017, and you go by WCM, Windmill Capital Management.

Brian Jones: Yes.

Stewart Foley: WCM has underwritten more than \$2 billion of commercial and industrial clean energy projects, including solar, wind, geothermal, cogeneration, and biomass. Talk to me a little bit about what is Windmill's investment strategy.

Brian Jones: So, when we started the firm, we were focused on a single technology really. We did almost exclusively solar. And we arranged cash equity investments in solar projects, commercial solar projects. And we've always aligned with developers. And so, as our developer partners have expanded geographically, they've become more diversified in the types of projects that they're pursuing to include other types of technologies, and their capital needs have evolved.

We have in turn evolved our business model and the types of things that we do. We look at a broader swath of technologies. You went through most of those today, cogeneration, solar, battery storage, et cetera, and geothermal, biomass. And then, we've also broadened the types of capital that we look at. Their energy is distinct in that it generates or benefits from some significant government incentives.

And so, monetizing those incentives, most notably tax credits, but other credits as well, helping developers monetize those credits if they're not able to use them directly. There's some unique fixed income investments related to that are sort of specific to renewable energy and that require some specialization. And then, of course, the equity investments themselves.

I think what really distinguishes us and differentiates us is a focus on commercial projects. There's a lot of very large, very well-capitalized infrastructure funds that are pursuing utility-scale projects. Those are relatively easy to underwrite. You've got a credit, an investment grade credit counterparty. And so, valuing those cash flows under a long-term contract are relatively simple.

It's a little bit more challenging with a commercial project and a commercial counterparty. And of course, the project sizes are smaller, but we see some real benefits in doing that. There's less competition, which means we think that returns are better. And we, in fact, think that risk adjusted returns for commercial projects are better than utility-scale and that's also because the risk is being mispriced.

And then, there are distinct investment opportunities. The equity ownership of the assets brings with it some tax protection from tax shelter, from depreciation deductions. There's credit ways to invest it. So, people are looking at the private credit market. And then, of course, there's also monetization of the tax credits themselves, which is a super low risk way to get more familiar with the space.

That's more of a CFO, treasury, tax manager type of investment, but it's an important part of the overall capital structure. And because I'm a CPA, my license is inactive, but I'm a CPA and I have a background in tax, it's something that we think that we can offer some expertise in for potential clients.

Stewart Foley: That's terrific. So, I mentioned earlier the ability for insurance companies to use their assets to positively impact their liability side of the equation. And for that reason, it seems obvious to me that commercial clean energy investments are appealing to insurance investors. How do we quantify that in a way for them? How do you look at that? How would you go about trying to quantify that to an insurance investor?

Brian Jones: So, on the one hand, when you're looking at avoidance of carbon dioxide emissions and things like that, it's very difficult to draw that straight line to reduced cataclysmic weather events and things like that. Those macro type risks are much harder to assess. But I'll give you a real firm example.

The San Francisco Bay Area is not known for severe weather events, but a couple years ago, two winters ago to about a year and a half ago, we had a significant storm, a lot of high winds and rain, and it resulted in a number of downed trees that resulted in some long-term power outages. Local utility here is PG&E. They've got a long-term plan to underground lines and otherwise fortify the distribution system.

But the power was out here locally for three or four days, and I'd heard from the manager of the local mega grocery store that they were not able to get on-site power or portable refrigeration. And as a result of the power outage, had about a million-dollar loss at that one store of perishables and frozen food. An on-site distributed energy resource, a DER that powers that store, specifically would've eliminated that loss.

It would've kept the store open at a time when the community needed that resource. You figure not only is the grocery store, they've lost power and everything in their refrigerators have perished, but the entire community was doing the same thing. All the homes had power outages. If you didn't have a backup power source, you lost your refrigerated food. So, you need to replace that.

Having a grocery store open in that circumstance is a key community resource. And of course, the store lost money not only from the direct losses, but from the loss of business for the four days that they were closed. An on-site power system, solar on the roof, with a co-generator producing heat and power would've eliminated those losses. The store would've stayed open, they would've thrown away nothing.

So, not only does it fortify against that sort of an event, but the power that they would get from that system on-site is cleaner, obviously more reliable, but it's also cheaper than the power that they're getting from the utility as well. So, there's a win-win-win for these distributed energy resources and I think that that's a key consideration, particularly for all investors, but particularly for insurance investors.

Stewart Foley: That's a terrific example. And just give me a little bit of education here. So, my next question is how do commercial projects compare to utility-scale projects? What I'm piecing together here is that DER, which is a distributed energy resource, is that correct?

Brian Jones: Yes.

Stewart Foley: That would be referred to as a commercial project versus a utility-scale project. So, can you talk a little bit about that? It's just helpful I think, just so people can relate to that. I never even considered that you could have an independent power source running in a supermarket, just a supermarket, and the benefits, societal benefits, forget about everything else, the societal benefits, there's obviously a lack of reduction in loss experience.

Because from an insurance perspective, you're a million dollars to the good right there, but you're also feeding people at a time when they really need it. It's my own ignorance, but I just didn't know that that was commercially viable. So, can you talk a little bit about that?

Brian Jones: So, I think that the lack of understanding around commercial projects is fairly common. Most people think about renewable energy as being these large-scale solar farms or wind farms that are providing power into the grid that's then distributed via the regular distribution network. There are obvious benefits from a renewability standpoint and an environmental standpoint to those types of projects compared to baseline power that's generated by coal or natural gas.

Until relatively recently, certainly within the last 10 years and likely even more recent than that, on-site renewable energy was not always cheaper. There was a premium to that energy. You had to find the benefit somewhere else, and that was due to economies of scale and the cost of engineering smaller projects and the cost of equipment and those sorts of considerations.

The falling prices for equipment and definitely falling prices on soft costs for permitting and design have enabled those commercial projects to be far more economic. But also, of course, not forgetting, we've got a tax credit, a 30% tax credit for these projects. So, the government essentially is paying 30% of that capital cost. So, having that established and now looking out 10 years made permanent, we've got great visibility on project cost.

We can enter into long-term agreements for the sale of that power to the on-site customer. And not only that, but we're able to, now with battery storage becoming far more economical, we're able to combine different technologies to provide the type of power that a particular project needs. So, something like a grocery store or a shopping center more broadly, or a hotel or a data center, they have need for both electrical power as well as heating and cooling.

And so, the ability to match the technology with the power needs is pretty critical. So, we're able to provide substantially 100% of that on-site power in a way that is less expensive than utility power. So, the cost consideration now, it becomes... it's not a cost consideration, it's a capital consideration. How do I capitalize that project if I'm the shopping center owner?

Or if I'm the grocery store owner and I own the site, I control the site, how do I fund the investment necessary to get that project completed? And that's where we come in. And I think that's what's really compelling for investors now is that difference, the economics around these smaller projects.

Stewart Foley: Just to be clear, I think the 30% subsidy that you referenced early in your answer is in the Inflation Reduction Act. That's where that 30% comes from.

Brian Jones: Correct. Yeah. We've had that tax credit for a number of years. The Inflation Reduction Act did two important things. It made it permanent. It expanded the types of renewable energy to include battery storage most notably, that were eligible for that credit. But it also made those credits transferable, which means that a developer that couldn't otherwise use those credits can now sell them in a far more efficient way.

And taxpayers, people with tax liabilities, mostly corporations with tax liabilities, can buy those credits and improve their cash flow, as well as obviously benefiting the development of clean energy. So, the Inflation Reduction Act did some really neat things for the industry.

Stewart Foley: That's cool. And so, I was at a dinner in Bermuda on Tuesday night and the topic of C-PACE came up. And I was, honest to God, just fascinated by the whole thing. Can you tell our audience how does C-PACE work and what is it?

Brian Jones: Yeah. So, PACE stands for Property Assessed Clean Energy. And C-PACE puts Commercial in front of Property Assessed Clean Energy. So, it's a financing tool that allows property owners to make improvements for energy efficiency, reliability or fortification, and for clean energy.

And then, finance those capital improvements over a long period of time, 20, 25, 30 years, typically at a fixed cost, at a fixed rate, and make those payments through their property tax assessment, their local county property tax assessment. So, what that means is that, as a property owner, I can make improvements, important improvements, energy efficiency improvements, asset hardening improvements against earthquake, and flood, and things like that.

I can add renewable energy to my site. And I can actually increase my net operating income by having reduced operating costs and the improvement in my operating costs exceeds the financing costs because I'm financing over such a long period of time. So, it's a great incentive for property owners to make important improvements.

And in a lot of cases, these improvements are being mandated by government. In California, we've got seismic retrofit deadlines that are coming in. New York has a new energy efficiency standard where after, I can't remember the details, but after a certain period of time, you're not going to be able to lease your property if you don't meet certain energy efficiency standards.

And that could be windows, that could be HVAC, that could be more efficient elevator systems, et cetera. All those things are financeable under C-PACE. So, it's a fantastic tool. And importantly, from the lender's standpoint, the providers of the capital, this is a senior financing. It's on par typically with property taxes. It's above in priority, the mortgage that's on the property.

So, as a result, these are highly secure, typically low loan to value, and therefore very appealing loans to fund. And pricing for these, just to give you a sense, is typically 400 to 450 basis points over the 10-year. So very, very appealing rates for lenders. And in particular, when you think about insurance specifically, where they've got, in a lot of cases, they have very long-dated liabilities, matching the duration of their assets to the duration of the liabilities can be important.

And so, these are very long-dated, they're fully amortizing. So, a 25-year might have an average life of 17, but that's a nice long-dated asset to have on the books at 400 over the 10-year. That's a nice premium.

Stewart Foley: And is there scale there? It's always a question of, for some of the folks listening to this podcast, it's like they need to be able to put money to work in size. Is that possible with C-PACE as well?

Brian Jones: Yeah. So, that of course is the... that is one of the tricky parts. And it's easy to go out and try and make a \$20 million, \$30 million loan. There are caps sometimes. The C-PACE programs are state-by-state, and so typically a state could have caps on the size of a particular C-PACE loan. For large projects, that can usually be overcome because you've got multiple parcels, so you split it out over multiple parcels.

So, there are definitely larger-scale loans that are available. We think that as this market evolves, and it's a billion dollar a year market and growing, I think last year was about a billion and a half of new issuance. So, the market itself is fairly robust and certainly growing. As it matures a little bit more... right now, it's still only available in, I think, 26 or 28 states.

As we get greater adoption and property owners are more aware of how it works and what the benefits are, and importantly, we get some of these deadlines around mandates for efficiency and the engineering of the projects, we're going to see more and more use of the vehicle. And I think that that's going to drive a lot of new issuance volume. And as we get more volume, again, the transaction costs are going to come down. The documentation costs and issuance costs are going to come down, and that's going to benefit both the lenders as well as the borrowers.

Stewart Foley: Absolutely. And it's one of these rare cases, it sounds like, where maybe an intermediate-sized investor may be at a competitive advantage because making a decent allocation here can fit with the portfolio and the availability of product as well. So, I've got a simple one for you before we get to the fun ones. We're coming up on time, so I want to be mindful of that. But I also want to know from your perspective, what does the future of clean energy investing look like from your seat?

Brian Jones: I think that we're going to see a couple of really important things. As I said at the kickoff, this is a multi-trillion dollar, multi-decade investment trend. And about half of it is related to electrification of transportation, and the other half relates to energy generation, clean energy generation.

So, it is an absolutely huge opportunity, and that in itself is going to show the means that things are going to evolve. I think that one of the most interesting... right now, it's primarily a private market. There's not a lot of public infrastructure funds, infrastructure companies. If you want to play renewables in the public markets, you're generally working with equipment manufacturers or installers.

And that's partly because there's not an appropriate pass-through vehicle for owning these assets longer term. So, right now, it's primarily a private market, which again benefits investors like insurance companies that have expertise in evaluating private managers, that have expertise specifically in private equity, private credit, and are comfortable with the lack of liquidity that comes with private investing.

But I think within a couple of years, we're going to see a complete transformation in the public markets, where right now there's a bill in Senate Finance Committee to allow the master limited partnership structure, to expand the master limited partner structure to include renewable energy. Everything that qualifies for the Section 45 credit would be eligible to be held in a master limited partnership. That allows broad ownership, public ownership of these assets with a single layer of tax.

And I think that that's going to reduce the cost of capital. That's going to drive a ton of new investment in the space. Early in my career, I saw the REIT boom, and your insurance asset managers will understand this. Back in the day, back in the '80s, early '90s, they owned everything, all their real estate, they owned direct. Now, they own their real estate in a combination of publicly traded real estate investment trusts and private direct investments or fund investments.

The energy markets are going to see the exact same thing, except at a much faster pace and at a much greater scale. So, that is what we see as coming down the pike. I think that, again, investors today are at an advantage when it comes to pricing because there's still a scarcity of capital, which means that you can get premium risk adjusted returns, and if you're investing now in owning the assets, you can benefit from that price expansion when the public markets start coming for these assets.

So, I think it's an incredibly auspicious time to be a renewable energy investor. And we're evangelists for the space. We haven't talked about climate hardly at all, but at the end of the day, this is one of the biggest drivers of abating climate change, not just here in the US but globally. And our ability to make investments that are driven by the bottom line, but have substantial impact as well, is really exciting for us. So, we're eager to get the message out.

Stewart Foley: And I think that when you were talking to a CIO, I think that they're all about impact investing so long as there is a competitive rate of return. And you're covering both bases there. And it's obvious to anyone listening to this that this is not just a passing fancy for you, that it's near and dear to your heart, and I think that really matters as well. There's a lot of purpose behind it too. So, I want to thank you for the incredible education on renewables today. I got a couple of fun ones for you out the door if you care.

Brian Jones: Absolutely.

Stewart Foley: Is there a piece of advice that you've gotten along the way that you'd care to pass along to your 25-year-old self or someone who's earlier in their career? And who would you most like to have lunch with, alive or dead? You can have up to a table of four, but don't have to.

Brian Jones: Wow. So, to my 25-year-old self. At 30 years into my career, I've had jobs that I've really, really loved. I've really loved different phases of my career. I don't think I've ever had the passion for what I do the way that I do now, and it's because there's multiple layers to what I'm doing now, both as an entrepreneur, as seeing the market opportunity, the vastness of the market opportunity is incredibly inspiring, but the impact and the ability to impact people's lives in often a very direct way.

When I consider, for example, what sort of community and social benefits can be derived from a partnership between on-site renewable energy and affordable housing, for example, those types of things are incredibly exciting. What the partnership between renewable energy and regenerative agriculture and what that can mean for our planet, those types of things are really incredibly inspiring.

And the vision for those types of collaborations, really, it takes me out of the day-to-day analysis, and it's a great reminder for why we're here. So, finding that passion, it's easy to say in hindsight, for me, it just took this long to find the convergence of something that is inspiring on so many different levels. But as a 25-year-old, I'm not even sure that I would've thought that way.

So, the advice going back is to consider that and strive for it, seek it out. Seek out that inspiration and that passion in what you do.

Stewart Foley: That's a great advice. What about lunch?

Brian Jones: Yeah, so lunch, that's really interesting. There are so many inspiring people that are doing things in different parts of life right now. There are leaders in the climate movement. There are leaders in democracy movements around the world. There are leaders in reducing geopolitical conflicts, but I'll use some local examples because I think that, they might not necessarily capture your audience, but I think that everybody will be able to sort of put this on a local level.

A couple days ago, Rev. Cecil Williams, who's the founder of Glide Memorial Church in San Francisco, passed away. Glide is one of the largest providers of social services to the poor and homeless and underserved segments of San Francisco. I actually did some volunteer work, it happened over the spring break. And he built from virtually nothing, he and his wife, a community resource that provides everything from housing, to legal services, to thousands of meals a week.

And I would love to have the opportunity to sit down with somebody like that and hear not only how did he do it, but how do you persevere, because he was 92, I believe. And the ability to persevere over a long period of time would be really something I'd be interested in talking to him about. I think that it's hard as an investor and an asset manager not to include somebody like Warren Buffett on the list and particularly asking him why he's not investing more directly in renewable energy today.

Berkshire has some oil and gas investments. They're doing some investments in lithium. But the utility of the future is going to be 100% renewable and it's going to be 100% distributed. And I'd be interested to talk to him about that.

Stewart Foley: I really enjoyed having you on. I share your passion. I love the insurance investment community. That's a great group of people. A lot of friends out there. And there's a lot of people who listen to us that I know personally, and it makes me feel so good when people say, "Hey, I really liked that podcast on whatever it was." And this community has been really, really, really, really kind to us. And as a fellow founder, I congratulate you on your success. I love your passion for it. And thanks so much for being on today.

Brian Jones: Well, thank you, Stewart. And I just hope that there was something of value in our conversation that listeners can actually take and use. That's my goal in joining you, and I appreciate the opportunity.

Stewart Foley: My pleasure. We've been joined today by Brian Jones, founder and managing partner of Windmill Capital Management. Thanks for listening. If you have ideas for podcast, please shoot me a note at stewart@insuranceaum.com. My name is Stewart Foley, and this is the InsuranceAUM.com podcast. We'll see you again next time.