Nordic Credit Rating

Soaring energy prices increase financial significance of green investments

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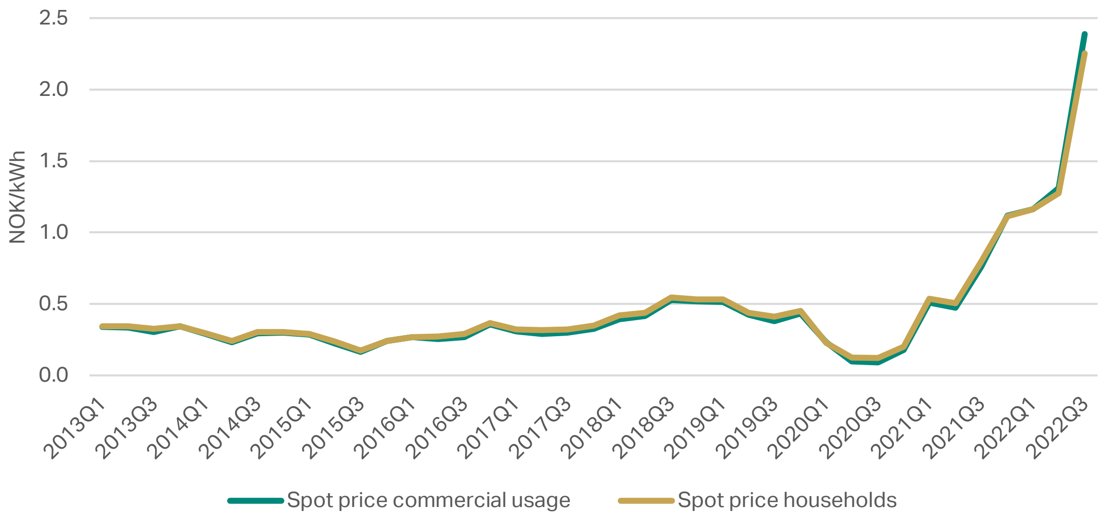
The past year has seen a dramatic rise in energy prices, as well as increased uncertainty over energy supplies and price volatility for the foreseeable future, following Russia's invasion of Ukraine and the EU's subsequent reduced purchases of Russian gas. This adds a new dimension to efforts to improve energy efficiency and add in-house generation, which have mainly been regarded as environmental investments. Nordic Credit Rating (NCR) is increasingly seeing a financial benefit for companies in reducing energy consumption. This article clarifies our view of the direct financial implications of investments in energy efficiency and generation, as well as our expectations of how continued uncertainty and price volatility could play into this.

A NEW NORMAL FOR ENERGY PRICES?

The coming months are expected to see energy prices continue to rise across Europe as the weather gets colder and supply remains limited. Sweden is particularly vulnerable, as one major nuclear energy plant is undergoing prolonged renovation. In response, some companies with relatively low-energy usage have opted to hedge energy costs, albeit at relatively high prices, in order to limit price risk. The Swedish government has proposed energy support for companies and households. However, the current plan only covers the period from October 2021 to September 2022, and the date for support payments is uncertain, especially for companies. In Norway, households have received subsidies on energy costs for some time, but only the most energy-intensive companies receive energy price subsidies.

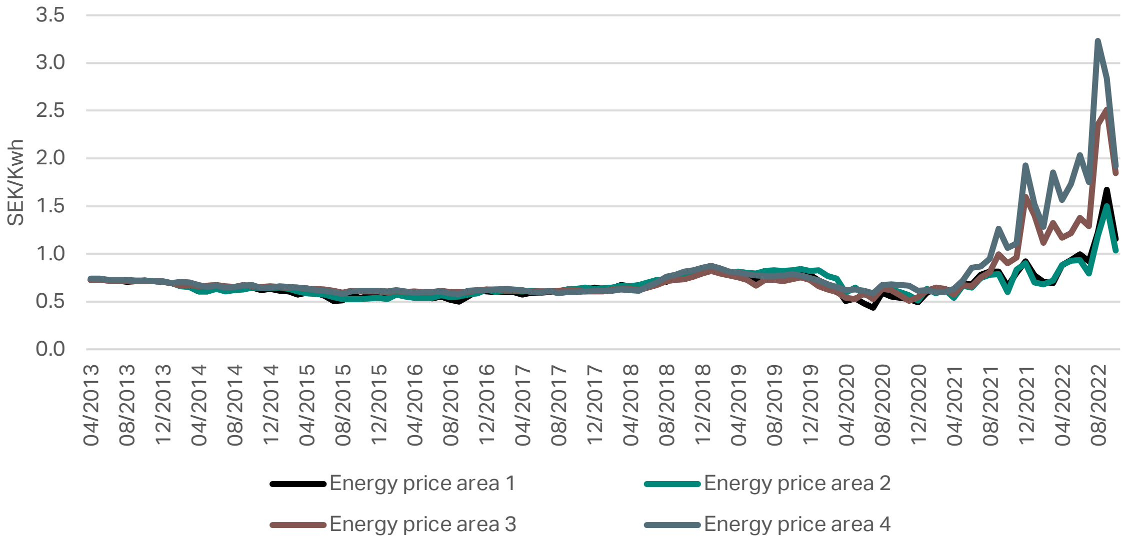
Figure 1. Energy prices, quarterly average, Norway, Q1 2013–Q3 2022



Source: Statistics Norway.

Given the long lead times for increasing energy production in the European electricity market, we expect high prices and continued volatility over the next few years. European energy prices are interlinked, implying that although neither Sweden nor Norway is directly reliant on Russian gas, prices are unlikely to stabilise until the EU as a whole becomes independent from it. This has been hailed as an opportunity to accelerate the transition to a fossil-free energy supply, but it comes with added uncertainty and expectations of high volatility in energy prices.

Figure 2. Energy prices for households, monthly average, Sweden, Apr. 2013–Oct. 2022



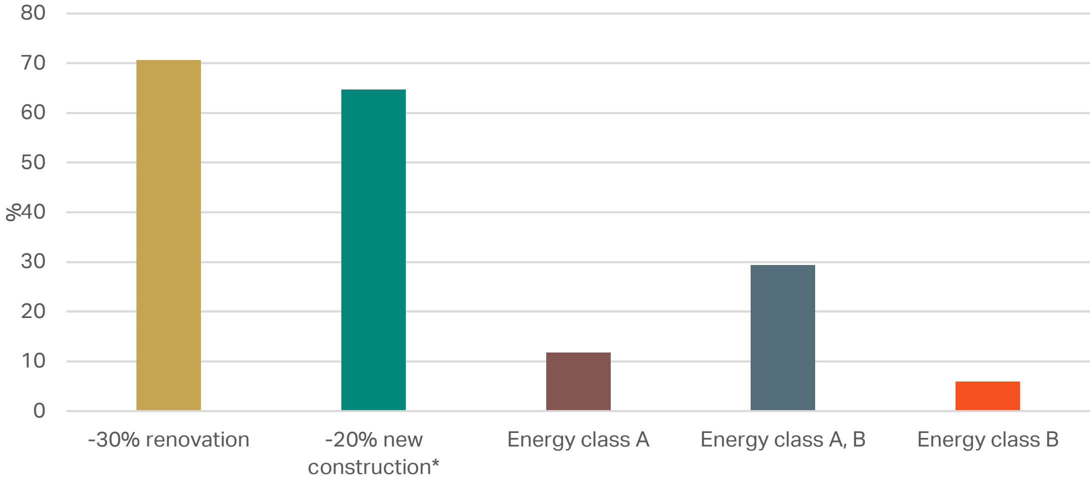
Source: Statistics Sweden.

As a result, energy efficiency has become an important part of corporate strategies and stakeholder communication, including for companies that did not previously place particular emphasis on it. We therefore view it as favourable for companies, both in the real-estate and wider corporate sector, to have invested in reducing energy usage and/or in-house generation of renewable energy. We believe the high price levels and volatility are likely to persist for some time, implying potential financial benefits of accelerating investments in energy efficiency or in-house generation. However, many companies, and property managers in particular, are being impacted by rising interest costs and scarcity of capital, which implies that such investments may not be feasible at the moment.

ENERGY EFFICIENCY INVESTMENTS SHIFT FOCUS

Outside the most energy-intensive sectors, investments in energy efficiency have often been closely tied to sustainability efforts. Reducing energy usage can be part of reducing total emissions, especially in cases where 100% fossil-free or renewable energy might not be available. In the real-estate sector, for example, energy efficiency (whether measured as energy class or energy usage per kilowatt hour (kWh)) is commonly used in green bond eligibility criteria, for property certifications, and as a selling point to tenants who want to decrease their environmental footprint. However, with energy prices rising rapidly since last winter and high prices appearing to be here for the foreseeable future, the financial benefits of generating more output per kWh of energy used have become more important across a number of sectors.

Figure 3. Percentage of NCR-rated real-estate issuers with green bond frameworks including energy usage reduction or energy class as eligibility criteria



Source: company reports. *Compared with national average. Out of 17 NCR-rated issuers, four of which do not have green bond frameworks.

Although energy efficiency investments may have been undertaken by companies, or their property managers, to reduce their carbon footprint, energy costs are increasingly significant to financial performance. Consequently, we are more likely to pay attention to companies' energy usage and efficiency in a higher-price environment. For property managers which charge at least part of electricity costs to tenants, we believe better energy efficiency could be beneficial in rental negotiations over the next few months. Many tenants face record increases in rent due to inflation-indexing in contracts, and control over energy costs for tenants might aid negotiations.

In addition to energy efficiency measures, in-house production of renewable energy, most commonly using solar panels, is often highlighted as a way of reducing companies' carbon footprint. While there has always been a financial dimension to this, it has been debatable, as they produce little to no solar energy in the coldest and most expensive months in the Nordic region. However, the expected payback period for these investments has decreased dramatically due to expectations of continuously high and volatile energy prices, including in the summer months.

In 2023, we expect companies to continue efforts to improve efficiency, despite higher interest rates and investment costs. Although these investments are likely to benefit their sustainability profile, energy efficiency investments are made much more attractive by expectations of continued financial benefits and a shorter payback period.

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