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Subsidy-free renewables conference

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Experts from all corners of the renewables market came together in a packed room at the St Pancras Renaissance Hotel in London on 6 November for inspiratia's Subsidy-free Renewables Conference

Renewable energy is a buyer's market

The current dynamic is one of too many projects and too few creditworthy PPA offtakers. In some markets where merchant prices are higher – such as Iberia and Mexico – this is leading to PPAs being signed at less than half the wholesale price, such is the competition for offtakers. Meanwhile, banks are sizing debt based on downside cases that are higher than the price of PPAs, capping the investor's upside and removing any financial advantage. What is a good price for the developer or offtaker is not necessarily a good price for the investor. In some cases, projects might be at risk of PPA termination in the future if prices don't increase sufficiently. "The worst thing you want to have is being tied into an offtake contract for 10, 12, 15 years and down the road the offtaker is not happy with that price," said Javier Santos of DLA Piper.

Know who you're dealing with

The removal of subsidies changes the identity of the PPA counterparty on the other side of transactions. Clearly, without government support, regulatory risk decreases – although regulators will continue to influence wholesale prices through, for instance, market design and decisions around storage capacity, which could in turn impact the viability of projects and PPAs. But the market's transition can also give project owners more freedom to draft contracts that more accurately match their preferred apportionment of risks, while hopefully still achieving desirable returns. It can also be a blessed relief for those who suffered in the past at the hands of governments in places like Spain. "There is less regulatory risk with

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subsidy-free deals and you also have the flexibility to assess a counterparty and create a PPA structure based on bilateral discussions," said John Laing's Erhan Yildiz. But agreeing a PPA with a different offtaker each time can increase the volume of work required of those involved in financing projects. Lenders will be compelled to not only assess the creditworthiness of the PPA counterparty, but also take a view on the offtaker's industry during the life of the PPA. "We've had to educate ourselves internally significantly over the last two or three years to individually understand every market and every offtaker and the power market behind that offtaker," said Gerard Pieters of NordLB. This is particularly true if the market moves onto the so-called second tier of corporates, although many of the top level Silicon Valley businesses involved in these deals can even also bring about questions from credit committees due to their relatively short histories of existence.

Merchant risk has to be part of the equation

Given the shortage of PPA offtakers, the market has to find a way to finance the massive pipelines of renewables projects on a merchant basis. "You can't build a market of the size we're talking about on the basis of PPAs only – that's not going to work," said Manuel Cabrerizo of Voltiq. This causes a predicament for equity investors. With yields going down, accepting full or partial merchant exposure might help them hit their required return targets, but it also changes the risk profile of their investment. This market mismatch could be bridged by trading houses such as Shell, according to Unsal Al of Shell Energy Europe. Similarly, the creation of synthetic PPAs is being pioneered by investment banks by bundling various power buyers into a single PPA. When it comes to accepting merchant risk, lenders appear to be the fastest movers, given many have experience dealing with natural floors and know the price at which numbers start to be uneconomic. For one, Banco Sabadell has first-mover advantage as one of the only commercial banks currently willing to finance merchant deals in Spain. Meanwhile, institutional debt providers – such as hedge funds or infra debt funds – are disrupting the space, being apparently more inclined to take on merchant risk than not only the banks, but equity players as well.

Market players will come and go – and evolve

These new market dynamics will have a profound impact on the profile of market players. The traditional role of a developer – identifying and building sites, and then selling them to institutional investors once they are operational – is not compatible with the current direction of the industry. "There's little room in the current market environment for development premiums," said Javier Huergo of FRV. Indeed, in many cases, institutionals are competing directly against the very developers who a decade ago they were buying assets from. By this definition, developers will have to become more commercial in their business. Those that come through this transition will be more vertically-integrated and in this regard, utilities may have a natural advantage. On the investor side, the lines may start to blur between infrastructure, private equity and commodity funds as merchant price risk plays an ever greater role.

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Market-specific PPA structures are developing

In the corporate PPA market, where contracts and structures are yet to become standardised, each stakeholder is looking to secure the best result for itself in a post-subsidy world. Confusing the picture even more, at least for those operating across borders, is that PPAs in different countries by no means mirror each other, compelling market participants to perform meticulous due diligence. "It's all about understanding the detail of market rules; each is very different in how they operate and the PPA needs to be tailored appropriately to that market and balance those risks," said Matt Brown from Poyry. But diversity in offerings in various countries can prove beneficial if any successes are exported to other markets. DLA Piper's Natasha Luther-Jones said, "The structures we're seeing in the Nordics are super interesting because you're effectively having baseload wind contracts where you take volume risk. I think that structure and how they deal with merchant risk and fixed prices is more innovative and we'll start seeing that in the UK." Other structures led by institutionals – so-called funded PPAs – are also emerging and, if the buyer's market forces corporate PPA prices ever lower, power supply contracts with utilities are always on the table for developers. Additionally, standalone generation projects may well become rarer as owners look to get the most out of their assets. The Green Investment Group's Bill Rogers said, "We think that combining multiple technologies, either in a single site or within commercial structures, is going to be an important trend to watch and corporates are starting to think similarly."

Fixed prices means cheaper capital

Offshore wind is an example of a market that has undergone rapid cost reductions in the last two years, driven by the introduction of competitive auctions and the development of larger turbines. But arguably the biggest single driver has been access to cheaper capital. With the market now trending towards merchant price risk – zero-bid auctions have taken place in Germany and the Netherlands – the introduction of long-term fixed-price contracts would allow the industry to maintain its competitiveness. "The difference between a fixed price of €50 per MWh and a fully merchant project with a forecasted price of €50 per MWh is enormous in this market," said Lisa McDermott of ABN AMRO. Introducing a stabilisation mechanism for renewable energy would enable continued access to the debt and equity liquidity that is now plentiful not only in offshore wind, but the wider market. Jerome Guillet of Green Giraffe said, "We converged towards an auction model which brought the prices down; there's no reason why we can't converge on long-term fixed-price contracts."

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