Policy Drivers for RE Financing

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- RE Finance Project
- Low Carbon Finance Group

Mainstream renewables financiers: project finance, specialised funds, pension fund advisors, investment banks.

Engage on actual policy developments: what attracts capital, what are the issues: evidence base into policymakers. First UK focused work in 2005 on 1st review of the RO.

Low Carbon Finance Group – senior energy finance practitioners from across finance spectrum, considerable investment experience in renewables; factual input to policymakers; EMR, EU.

Policy & investment basics

- Risk: reward - internally RE must be comparably attractive to other more conventional, lower risk, better understood investment options.

- Policy is central to creating conditions to attract capital to the sector: RE has not been directly competitive with conventional energy options; risk profile varies between sub-sectors.

- Policy risk/certainty (and perception thereof) is critical given potential impact on project economics, revenue generation.

‘Investment Grade’ Policy

- Key policy characteristics - ‘long, loud and legal’, (2004); ‘TLC’ (Deutsche Bank)
- Examining actual policy developments (UK/EU): lining up all policy or regulatory factors involved in closing deal.
  - Clear objectives - is it clear what this policy is aimed at (linked to understanding when govt might review policy to stay on track)
  - Planning/licensing/consenting
  - Grid/distribution infrastructure – availability, access, cost (anticipate new policy/regulatory needs of new technology)
  - Policy coherence across relevant supply chain (eg biomass)
  - Stability across project-relevant time horizon
  - Clear forward scale of ambition (‘growth story’/pipeline)
  - COMPLIANCE/enforceability
  - Cross-border issues (infra, trading)

EMR: Principles of attracting capital - Low Carbon Finance Group submission

Support mechanism

- Stability and predictability (price, revenue stream)
- Simplicity for new entrants
- Level playing field (route to market for independent generators)
- Inflation linkage
- Transparency
- Affordability (linked to perception of stability)

- Overall bankability – the package has to add up
- ‘0-60’ how quickly financiers get comfortable w new conditions

FACTOR	Fixed FIT	Premium FIT	CFD: as proposed	Factor importance to financiers	CFD FIX
Price stability and predictability	●	◐	◐	●	Minimize/eliminate index basis risk (e.g. Irish model). No auctions as they increase price and outcome uncertainties increasing cost of capital and reducing investor appetite.
Simplicity for new entrants	●	◐	◔	◕	CFD has many variables, increasing perceived complexity; price stability and purchase obligation can cure.
Level playing field: Firm purchase obligation	●	◐	○	●	Create mandatory purchase option by utilities or other creditworthy central buyer.
Level playing field: Reform of balancing market	●	◐	◔	●	Reform balancing market with fixed charge for all generation, or ban utilities from balancing market (Spain).
Price stability: Inflation linkage	●	◐	◕	●	Pension and insurance investors' desire for inflation linked assets. Analysis assumes linkage.
Bankability	●	◕	◔	●	Adopt other solutions, especially price stability, purchase obligation, no auctions and balancing reform.
0-60 Speed	●	◐	◔	◕	Accelerate review; fix elements above.
Transparency	●	◐	◔	●	CFD parameters (indices, balancing costs, strike price, no auctions) must be visible and established quickly.
Affordability	◐	◔	●	◕	CFD addresses this well. A Premium FIT, with consideration of a cap and floor price, could also achieve this result.

The level of dark green in each ball indicates the effectiveness of each regime against each factor. The fourth column shows the relative importance of the factors.

EMR current issues: ‘Devil in Detail’

- Overall complexity – adds cost
- Timing – linked to 2017 and project development time horizons
- Risk and design detail

  - Payment model – creditworthiness of counterparty (is it with government), enforceability (‘who do you sue’)
  - Route to market – ability to sell power into the market as current ‘obligation’ on suppliers under RO comes to close
  - Access to CfD contracts – where there is constraint
  - CfD strike price setting – reference price determination and basis risk, and particular concerns over potential introduction of auctioning as early as 2017
  - CfD/capacity mechanism interaction, linked to assumptions about overall electricity market operation.

Cost of Capital

Cost of capital assessment – theoretical economic modelling not same as assessment by finance practitioners,

Different pools of capital operate under different return requirements and different appetites for risk

LCFG notes several external factors also impacting cost of capital:

- Rising interest rates
- Pension deficits (liabilities exceed present value of assets)
- Changing utility risk profile
- Financial regulations
  - Basel III (greater capital reserve requirements ref LT loans)
  - Insolvency II

Economics and Finance….

- Writing the impact assessment: what is the interface between economics and finance?

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