



Financing wind beyond 2010

Overview

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This financing study was carried out by BWEA from June to September this year. The aim was to develop a BWEA view of the entire issue of financing of wind farms both on and offshore the purpose being to develop a BWEA position statement which would be central to the Government's review of the RO mechanism which is currently scheduled for 2005/2006.

This survey is the most extensive that has ever been carried out in the BWEA's history; there are many pages of survey results; financial analysis of the RO as well as discussion of potential solutions and we have summarised these within this document. If you require additional detail please feel free to contact us at any time.

Introduction: During July and August 2003 64 interviews were conducted with key institutions in the wind industry and related sectors. Interviews were conducted either in person (45) or via conference call (19). Details as follows:

Category of company surveyed	Number
Financial advisory	7
Debt financier	14
Equity investors	3
Utility (with RO obligation)	7
Developer	14
Turbine manufacturer	3
Contractor	2
Lawyer	3
Other	11

Before going into the key findings and results from this BWEA commissioned study it should be emphasized that, at this stage, the conclusions/findings of the report do not represent official BWEA policy. The purpose of this study has been an attempt to identify potential problems in order to raise these for discussion and prioritisation with BWEA members.

At the present time BWEA is consulting its members widely on this report and, following this consultation process, we intend to form a BWEA view on the entire issue of the

bankability of the RO and hence the likelihood that the British wind industry will be able to meet a large portion of the challenging targets that the Government has set for renewable energy by 2010. Once we have formed such a view we will formally submit it to Government.

The report consists of two documents which are available at our web site; the following is a summary of the key points arising from those reports.

Wind and the financial community:

The financial markets are clearly very interested in the UK wind sector; there are a large number of well informed and experienced financiers that are keen to be involved in financing renewables project. Nonetheless this high degree of interest is tempered by concerns over the level of regulatory risk inherent in the RO.

While most banks have made a case that renewables are different to the main power markets; it was nonetheless frequently noted, during the survey process, that the financial community has suffered significant write-downs in conventional power projects in the past few years as a consequence of regulatory changes.

Notwithstanding this point the financial community is unanimous in their view that the RO system should not be radically changed. Such action at this stage would shake confidence. In addition 3 or 4 years would be required for companies to get comfortable with a new scheme.

Regulatory risk in the RO:

The fundamental point about the RO is that any investment made under it is exposed to the numerous reviews and potential changes which may take place in the RO at any time between the moment that investment is made and the time at which invested capital is fully repaid from project cash flows.

Key areas of concern relate to co-firing (a technical consultation is already out and BWEA will be responding), the EU's report on the potential for a harmonised renewables system in 2005, the UK's scheduled RO review in 2005/6, Emissions Trading, EU harmonisation, levels of consumer concern re environmental issues, the degree of political commitment to the RO and grandfathering.

Any solution will need to address these concerns.

Possible solutions:

20% by 2020 and Rolling Targets. The most popular seemed to be an extension of the RO targets from 10% by 2010 to 20% by 2020.

A related concept is that of rolling targets: For instance the Government would, every year, declare a renewable target for (for example) 15 years ahead.

The report notes that while both the 20% and rolling target concepts are intuitively appealing they nonetheless do not address policy and effectiveness problems that are inherent in the current RO mechanism.

In this regard the report contains interesting analysis which postulates that, due to regulatory risk and the consequent unwillingness of financiers and suppliers to bank the RO, the current mechanism is only about 30% efficient. It goes on to state that both 20% and rolling targets do not address this fundamental problem. It further notes that unless this inefficiency is tackled there is a real danger that the consumer will consider the RO price to be the cost of developing renewables and hence that renewables are unacceptably expensive.

Caps and floors. The idea of this is that an administrative minimum and maximum level of the ROC price would be set. This would be achieved by the Government writing a

floor on the ROC price in exchange for which it would buy a ROC price cap from industry. This could get over the risk of the ROC price falling to zero and might also address Government concerns about excess returns.

The report notes that this system could suffer from many of the problems of the NFFO mechanism due to the bidding process for the guarantees. Determining the collar corridor could be a significant administrative burden on both Government and industry and there would be no guarantee that any specific floor would lead to projects being developed. There would also be a significant potential liability for the Government if ROC prices fell below the floor.

PFI style deals. The report proposes that one way to get around the deadweight costs in the current system would be to have the Government issue contracts for the construction of wind farms as it does for schools, hospitals and prisons. Under this mechanism the Government would be able to bank the funds in the RO in a manner that the private sector does not currently appear willing to do.

Nonetheless the report notes that it is not clear that the Government would be willing to support such a radical change to the system and it also notes that such a significant alteration to the RO mechanism would take a substantial amount of time to 'bed down' with financiers, electricity suppliers and wind farms developers.

Vintage ROC n' Roll (RO banded in time). This would appear to be an entirely new concept that has not to date been discussed anywhere else. While a minor change to the RO mechanism is needed for this proposal to take effect, change is not required for the rest of this decade and there is no need for the Government to make any promises now concerning new renewable targets beyond 2010.

The fundamental point lying behind it is that the 'vintage' of the ROC generator would matter after March 2011. Any generating station accredited to be operational prior to 31st March 2011 would be 'Vintage One'. For the rest of the period of the current obligation (from April 2011 through to 2027) suppliers would be obliged to purchase 10.4% of their total electricity sales from 'Vintage One' generators or they would have to pay the buy-out price.

Nothing else would be required at present; however in, say, 2006 or 2007 the Government would declare the terms of a new vintage covering some period after 2011. This new vintage could incorporate changes to the rules on things such as co-firing, the buyout price etc. without affecting any investments made in plant of Vintage One. This gives policy makers a means of providing long term incentives whilst not having to make an open ended commitment long into the future.

It is important to re-emphasise that BWEA does not yet have a view on the effectiveness of the current RO mechanism or whether changes are needed to it in order to encourage investment. This entire issue is now out for consultation with our members and during this process BWEA will also be discussing the matter of financing with other industry bodies. Only after this will BWEA adopt a formal position and once we have done this we will share it with Government.

Your thoughts and views on RO bankability, particularly during this internal consultation process, would of course be much appreciated. Please forward them to James Glennie at james@bwea.com or Tel: 020-7689-1967