A call for evidence on barriers to securing long-term contracts for independent renewable generation investment

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Introduction

Community Windpower Limited makes a response below to the call for evidence as issued by DECC on 5 July 2012. Community Windpower Limited is an independent windfarm developer, owner and operator with 84MW of generating (onshore) assets in the UK. We currently have three long term PPAs and are in the process of negotiating a fourth. We are well placed to make comments on the current market as we have been negotiating and banking PPAs during the period under review. All of our windfarms are project financed.

1. ***Please could you provide a summary of your experiences with the PPA market over the past three years:***

a) ***How many counterparties have issued responses to your PPA tenders and has this number changed? If this number has changed, what has the trend been over this period?***

Our tendering process for PPAs involves approaching up to ten PPA providers, both utilities and non-utilities. Three years ago we would have expected 'good' responses from all ten providers – the reference to 'good' is in respect of bankability. Our most recent tender has seen the number of responses fall by 50% with some utilities indicating that their terms would not be bankable and other utilities deciding not to quote.

b) ***Generically, what proportion of these responses have been from utilities and what proportion from independent aggregators/non-utilities? Have you seen new PPA providers enter into the market in this period?***

Utilities would typically account for 80-90% of responses. We have seen two new entrants.

c) ***Typically, what length PPAs have been offered to you in responses and if this has changed how has it changed?***

The usual term is 15 years to match the debt tenure. PPA providers are still willing to quote for this term but pricing in most recent offers has been scaled back beyond year 10 to represent increased market risk looking forward. Discussions with offtakers reveal that a ten year term would limit their exposures to (long-term) market risk which in turn would allow them to consider the level of risk and reward that can be afforded with a shorter term PPA.

d) ***Broadly, what are the sizes of discount factors that have been included in these responses and if these have changed how have they changed?***

Discount factors have worsened by on average 5% across the basket of prices on offer.

e) ***Have floor price levels and conditions changed and if so, how have they changed?***

Yes, we have seen considerable changes. Previously we could expect a fixed floor or indexed floor across the term in the region of £28-£30/MWh for Brown Energy. More recently, some utilities are no longer willing to offer a floor and we are tending to see stepped floors on offer – for example: £30/MWh for years 1-5, £25/MWh for years 6-10 and £20/MWh for years 11-15.

f) Has the nature of risk allocation relating to imbalance, change of law and collateral changed and if so, how has it changed?

This is one of the most significant changes following the introduction of the EMR. The change in law provisions now tabled anticipate a doomsday scenario with potential ROC revocation and a worsening of imbalance risk as market price volatility increases. Some of the risk associated with EMR has been reflected in the recent pricing offered within PPAs but other clauses are now being introduced by offtakers to push imbalance risk back to the generator.

g) Have financiers become more or less risk averse and if their risk appetite has changed how has this impacted the terms PPA terms they are requesting to secure project finance?

Financiers introduced a requirement for a floor price but the market responded to this request during the period under review. However, as commented above, the provision of a floor price is now more onerous and PPA providers have reduced the level of the floor. Financiers have become more risk averse as the banking market has changed and capital markets have reduced liquidity. PPA terms are required that match the debt tenure or even go beyond this term. The concept of a 'merchant tail' is no longer a viable option.

2. Have you seen significant changes to the PPA market over the past three years, and if so, what do you think has driven this? If you have asked PPA providers for explanations of why changes have occurred, what reasons have been provided?

We have seen the PPA market dry up over the past three years. There are now only a couple of 'players' with one offtaker providing nearly ALL of the PPAs banked during the past 18 months. The monopoly that exists has resulted in worsening terms for independent generators.

We believe that two factors have caused this market disruption; a) uncertainty created by the governments delayed decision on ROC rebanding and reports that the government intend to cut financial support for onshore wind, and b) the removal of the ROC regime and the introduction of the EMR. The second factor is probably the most relevant in addressing the changes in the PPA market. The Renewable Obligation (RO) ensured a commitment to renewable development but the EMR has not sought to replicate the same level of commitment. The removal of the RO at 2017 caps the level of obligation at this point and as a consequence, utilities are no longer engaged in the process of writing and signing up to PPAs to fulfil their obligations – much better that they purchase ROCs on the open market rather than expose themselves to 15 year contracts which will present a greater perceived risk following the introduction of EMR post 2017.

At the recent DECC workshop, it was evident from discussions with the representatives from utilities that the 'variability' of wind generation does not create an attractive commercial proposition once the renewable obligation is removed. This is contrary to the Government's opinion that suppliers and independent aggregators will continue to offer PPAs as there will be commercial opportunities to do so. This is obviously not the case, given the current state of the market and the need for DECC to engage suppliers and generators to consider market dynamics that may 'kick start' the PPA market.

3. ***How does the GB market for PPAs compare to other international markets? If you operate in other markets, how do PPA structures and terms differ? If terms differ what are the drivers behind the differences?***

We are not able to comment on this as we only operate in the GB market.

4. ***What are the factors preventing or encouraging participation in the GB market? How (and why) do you expect these to change over time?***

Market stability is critical with defined and reliable routes to market to encourage renewable generation investment. As an independent developer and generator in the onshore wind industry in the UK, we have serious concerns about the ability to deliver future projects given the current state of the PPA market and the erosion of support for onshore wind. The recent government announcements and proposed changes have unhinged the market and there is a serious risk of a hiatus until the industry, including financiers and investors, is able to move forward with a stable operational framework which is both transparent and reliable. If we have to wait until post EMR for this 'stable' proposition to come to the fore then we may have already damaged the industry beyond repair.

It is difficult to see how the PPA market will now recover following the removal of the RO at 2017. The operational framework for the proposed Contracts for Difference (CfD) is not sufficiently developed to provide investors with certainty of routes to market. In fact, the introduction of CfD appears to introduce an additional hurdle for projects to address – a CfD needs to be secured, and is by no means certain, before a project may then go forward to negotiate a PPA. Furthermore, the CfDs will be allocated in line with the Government's desire to support certain technologies and manage their cost exposure – all of which creates risk of deliverability.

5. ***Do you expect the EMR package to change the PPA terms that you might offer/receive and if so how do you believe they will change? What do you think is the primary driver for these changes?***

As stated above, the introduction of EMR has created uncertainty in the market and this has already changed the terms being offered in current PPAs. The EMR package and potential routes to market is nowhere near sufficiently developed to comment on PPA terms that we may receive in the future.

6. ***What has been the determining factor in selecting a preferred PPA and PPA provider?***

There are two determining factors; price and bankability. However, this is strongly caveated with the fact that in a market with very few providers, the availability of bankable PPAs is the determining factor.

7. ***Have you seen a change in investment returns as a result of the changing nature of PPA terms and can you provide an example, including how this has been calculated? Do you expect the EMR package to change investment returns, and if so what is the driver for this?***

As stated above, we have seen a reduction of 5% across the basket of prices offered in a PPA. We cannot comment on the EMR package.

8. ***What are your views (costs, benefits and risks) on the potential options discussed in this call for evidence that may be necessary to achieve the Government's objectives?***

Various options were considered and discussed at the recent DECC workshop. Many of the options appeared to be impractical given the current state of the market, for example the role of aggregation – it was agreed that it is highly unlikely that an independent aggregator will surface in the UK market given the level of capital required to fund a market position and similarly, self aggregation would be a non-starter as it not be easy for developers to pool projects with other developers to reduce forecasting/imbalance risk because developers do not have routes to market other than project specific PPAs.

The proposal to introduce a standard PPA or introduce an offtaker of last resort would provide a safety net but would not provide the competitive market dynamics to ensure 'best' price and a fairly balanced PPA for the generator. The market would gravitate to a pre-ordained (last resort) position which in turn would further weaken the PPA offering.

9. ***What are your views of the potential for market distortions and possible impact on the wider market?***

The introduction of EMR has already had an impact on the market which in our opinion should have been anticipated. The removal of the RO has resulted in a weakened PPA market. Government initiatives to 'kick-start' this market would be welcomed but would undoubtedly lead to market distortion, depending on the type of initiative introduced.

10. ***Can you identify and explain any other viable options (voluntary, competition based, regulatory or otherwise) that should be considered?***

The Government should retain the obligation for utilities to buy renewable energy under the EMR – in line with the existing obligation. EMR pricing (strike price) should be linked to market pricing (monthly average) plus the equivalent value of the ROC; until such time as the pricing of carbon costs are sufficient for the 'market' price to support renewable energy. Once carbon becomes fully valued then renewable technologies will become competitive on a 'full life cost' basis against gas, coal and nuclear.

The extension of the obligation beyond 2017 would encourage utilities back in to the PPA market and stimulate competition that doesn't currently exist.