Renewables outlook 2014

Intermittent certainty

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Jones Lang LaSalle's ("JLL") Renewable Energy Capital team supports developer, operator and investor clients in maximising the benefits and long-term value from renewable energy projects and development assets. The team provides a range of corporate finance expertise covering fund raising, deal structuring, due diligence and valuations. The team has built a unique track record of consistent out-performance across a wide range of renewable energy mandates. Our clients include developers, investors, property estates, corporate entities and local authorities.

In many ways 2013 represented another typical year for the renewables industry with technology costs falling and political voices rising. We expect these trends to continue in 2014 with further innovation and important votes on Scottish Independence, European parliamentary elections and the UK national election in the pipeline. It is in this context the UK renewables industry must consider its continued progression towards EU 2020 renewable energy targets.

Changing winds

The rising political noise comes as the global economic outlook is improving. The UK is experiencing its strongest growth since the financial crisis and according to the IMF is set to be the fastest growing economy in the G7 this year. Elsewhere in Europe there are also sustained signs the economic recovery is building momentum. This should be encouraging news for the renewables industry, which will also benefit from associated increases in energy demand and rising investment. However, these benefits come with new political risks as disillusioned voters tired of austerity are increasingly drawn to populist anti-establishment political parties who often pursue anti-renewables policies. These parties tend to be vocal in their dislike for "expensive" renewable energy technologies and "costly" carbon reduction programmes. In the UK these messages are particularly pertinent as the various political parties begin to position themselves for the general election in 2015. This creates additional political risk for renewable energy investors unsure which way energy policy will swing in what is expected to be a tight election.

Enduring trilemma

With increasingly populist arguments coming to the fore concerning the energy sector it is worth reminding ourselves of the three fundamental principles driving the evolution of the sector. These are the need for energy security (as recently highlighted by the crisis in the Ukraine), affordability (often linked to the cost of living debate) and decarbonisation (as embodied in the EU carbon and renewable energy targets for 2020). Of these, the drive to decarbonise is the one most often overshadowed in times of economic strife, as affordability demands and pressing energy security concerns take precedent. However, the imperative to meet the EU carbon and renewable energy targets continues to grow and was recently emphasised in the latest International Panel on Climate Change (IPCC) report, which found carbon emissions were still growing and the rate of growth is in fact increasing. To turn this tide the report concludes further measures should be taken to ensure renewable energy becomes the major energy generation platform for the future. In this context establishing new 2030 targets is seen as an important means for building investor confidence, ensuring a liquid pool of capital and maintaining development momentum post 2020.

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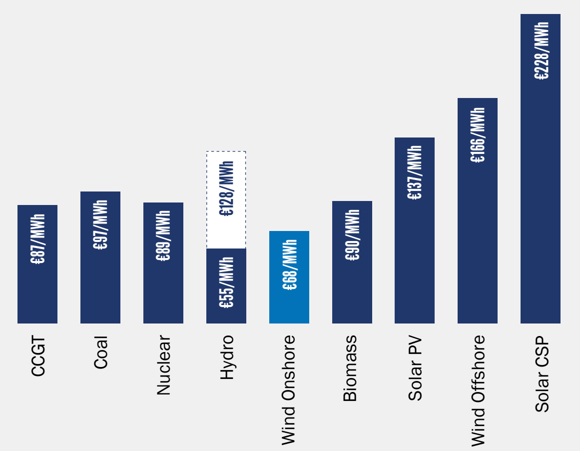
Clean, cheap and here

Certainly the case for transforming to a renewables based future has been significantly enhanced in recent years by the substantial performance improvements and cost reductions realised across a number of mature technologies. According to the IPCC report, costs for solar PV systems fell by 57% between 2009 and 2014. Costs for other technologies also showed significant reductions over the period with onshore wind decreasing by 15%, landfill gas by 16%, municipal solid waste by 15% and biomass gasification by 26%. In some instances large-scale hydropower, larger geothermal projects and onshore wind power plants are already competitive alongside traditional energy sources.

Levelised Cost of Energy (LCoE)
(€/MWh, 2012)



Source: EDP (2014)

Creative destruction

The performance improvements and cost reductions experienced in these sectors and most notably in solar and onshore wind have led to rapid deployment at scale in the UK. In the UK onshore wind is now considered the most mature, bankable and scaleable technology to deploy in the run up to 2020 with solar PV hot on its heels. These two technologies have both benefited from the support provided under the existing Renewables Obligation (“RO”). Despite the occasional RO banding review this continued support has generally provided projects with a long enough runway for them to be financed and built with a high degree of confidence.

However, challenges remain as the speed of change has proved disruptive to all but the most carefully crafted government forecasts. This in turn has put increasing pressure on government funding mechanisms and the domestic and commercial energy bills which support them. Adapting to these changes without undermining the investment case for renewables is proving challenging and a sufficiently robust policy framework has yet to emerge flexible enough to accommodate the fast pace of change without significant short-term interventions.

Safeguarding havens

In spite of these periodic policy revisions the UK renewables sector has been a relative safe haven for renewable energy investors. This is largely due to the government’s strong commitment to grandfathering support for renewable energy projects and avoiding retroactive changes to support mechanisms. This has been a necessity for investor confidence in the sector and has delivered over £34 billion of investment in large scale renewable electricity since 2010. However, despite this success a further £100 billion is still needed if the UK is going to meet its 2020 targets. Ensuring this is possible without placing an undue burden on taxpayers is a tricky equation and it is important for the government to find a sustainable balance between attracting the necessary capital and ensuring value for money.

Victim of success

The solar PV industry is the latest sector to fall victim to these competing pressures as evidenced by the government’s recently announced consultation on solar PV, which proposes an end to Renewable Obligation (RO) support for ground mounted solar above 5MW. This unexpected announcement follows a period of rapid deployment in large scale solar PV which has outpaced official forecasts and is putting undue pressure on the Government’s Levy Control Framework (LCF), which sets the overall annual limit on DECC’s levy-funded policies. DECC’s latest forecasts suggest 3.2GW of large scale solar PV will be built by April 2015 (previous forecasts suggested this level of deployment would not be achieved until 2017).

Brave new world

The solar consultation brings into question the future of large scale PV in the UK and represents a significant deviation from previously expressed government intentions. In the short term the industry will continue to connect 1.4 ROC projects until the end of March 2015, but any project at risk of being commissioned after this date will need to get up to speed with the government's new Contracts for Difference (CfD) support mechanism, which will take the place of the RO for large scale solar projects. This new support mechanism will expose solar PV to a competitive price discovery allocation process in which mature renewables technologies including onshore wind, solar and biomass co-firing will all compete to secure CfDs.

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Tempting fate

Further details on the overall allocation and bidding process have yet to be published and it is these details which will ultimately dictate the fortunes of solar developers in the UK post March 2015. Key questions to be addressed in the lead up to the first allocation round in October include how many megawatts will be available to bid on for solar and will other eligible technologies such as onshore wind also be competing for CfDs? However, until the government publishes its response to the solar consultation (expected in July) there is little developers and investors can do but muse about potential bidding strategies and known risks associated with the new CfDs.

With the solar market expected to cool in the second half of the year, equity funders and project finance lenders are already starting to look at alternative investment strategies for next year. Bio-energy is seen as having considerable potential with some investors even looking to fund semi-merchant projects. This continued investor appetite for the UK energy market is encouraging but both developers and investors should expect further policy revisions in the future, especially where technology specific deployment forecasts are expected to exceed official forecasts. The fortunes of the large scale solar sector represent a cautionary tale for other technologies with equally disruptive potential.

Intermittent certainty

The renewables industry can hope for sustainable, predictable and dynamic support policies but would be wise to prepare for more uncertainty and last minute policy twists. Living with this state of intermittent certainty is to embrace discomfort and change but developers and investors should take some comfort that the fundamental forces shaping renewables policy in Europe and the UK remain strong and will continue to grow. ■

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The JLL Renewable Energy Capital team provides in depth commercial and financial advice to developers and investors in the United Kingdom and across Europe. We advise on all aspects of transactions in green energy generation.

JLL is unique in combining corporate finance expertise with dedicated renewables planning capabilities to offer clients bespoke advice from project inception to operation. As part of JLL, the team benefits from an operating presence in all key markets and unparalleled access to a global network of investors seeking opportunities in this emerging sector.

We offer a tailored service, including the provision of renewable energy market entry advice, commercial due diligence services, the creation of bespoke investment structures, strategic partnering advice, specialist valuations and the execution of efficient fund raise and asset sale processes.

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