Lack of subsidies for renewables will boost PPAs

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"The incentive to develop renewables in the UK without government support or subsidies will drive innovation in PPAs, hedging and other risk management products", says Adrian Barrus of Slaughter & May.

It has become increasingly difficult to secure contracts for difference and other forms of government support or subsidies for renewables in the UK, leaving developers looking at other ways to bring projects forward in the UK – or shifting to overseas markets where there is some form of government support or subsidy.

The cost of renewables has fallen significantly and projects benefit indirectly from government policy on carbon emissions and sustainability even if no subsidy is paid, but large-scale projects remain capital intensive and, with investors and banks reluctant to accept risks associated with future power prices, there is demand for long-term revenue stability.

Appetite for PPAs

This demand has been a factor in the increased take-up of renewable corporate power purchase agreements (PPAs). Last year there was a significant increase in the number of renewable corporate PPAs and there is an appetite for this trend to continue, with corporates taking an increasing interest in procuring renewable power to meet their sustainability goals.

However, will there be enough renewable corporate PPAs to meet demand for long-term revenue stability? The use of corporate PPAs has been more popular in the US to date, with tech giants such as Amazon, Microsoft, Google and Facebook – as well as other large corporates such as AT&T and Walmart – signing up to corporate PPAs.

There is a market in the UK for renewable corporate PPAs, but questions have been raised about the depth of this market. In practice, we could see individual corporates supporting small-scale renewables with PPAs to meet their sustainability goals.

Large-scale projects

What about large-scale renewables? Developers have been able to sell "tranches" of generation to corporates to support larger projects. A market has developed for synthetic PPAs and hedging products that can provide revenue stability, as well as structures involving risk-management products from insurers.

However, there is a cost associated with using such products. In practice, developers may look to keep such costs down by putting revenue stability in place for only a proportion of generation or for a limited number of years. There is a trade-off associated with this. In the absence of long-term revenue stability, the developer is likely to face higher financing costs, lower levels of gearing, increased requirements for equity funding and shorter-term debt with associated refinancing risk.

The challenge will be to develop an efficient structure for the project in question, taking these different factors into account.

Mitigating risk

The debt itself can be structured to mitigate risks associated with future power prices and keep

financing costs down. The use of different tranches of debt or structures that lock-up cash in the project or adjust the level of debt in response to a financial model could form part of an efficient debt structure for large-scale renewables, taking into account any revenue stabilisation products that the project may have in place.

Lastly, technical developments such as co-location of battery storage and renewable hydrogen production using excess power have the potential to improve revenue stability and provide alternative revenue streams to support the development of large-scale renewables.

In the case of battery storage, costs have fallen dramatically in recent years with developers and investors looking at the potential for co-location with renewables. In the case of renewable hydrogen production, there is some way to go but it is something that the Oil & Gas Authority (OGA) is looking at.

In practice, the solution to unlocking large-scale renewables in the absence of government support or subsidies is expected to involve a mix of corporate and synthetic PPAs, hedging products and other risk management products, together with efficient debt structuring and technical developments.