Take two for Egypt’s solar FIT

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With the financial close deadline nearing for projects awarded during the 2GW first round of Egypt’s solar feed-in tariff (FIT) programme, the government is now turning its attention to the second round.

The Egyptian government is offering much lower tariff prices for round two, partly reflecting the typical reduction in incentives following an introductory tender but also the dramatic drop in the prices being paid for solar in the region. A consortium of Fotowatio Renewable Ventures, Masdar and Abdul Latif Jameel bid $0.0299 per kWh in May 2016 for the third phase of the Rashid al Maktoum solar project in Dubai, for example.

In comparison, Egypt’s first FIT round, launched in September 2014, was offering $0.1434 per kWh and $0.136 per kWh for plants between 20MW and 50MW in size and 500KW and 20MW in size, respectively.

A number of projects awarded in round one are unlikely to meet the 27 October 2016 financial close deadline, and are expected to be rolled-over into the second round. If they do fall into round two, they will be paid the new reduced tariff prices for power.

Several development finance institutions (DFIs), such as the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), CDC Group, the European Investment Bank, the Overseas Private Investment Corporation and Proparco, pulled out as lenders from the first round due to a dispute relating to international arbitration.

The government now hopes that a resolution to this problem has been found and that there will be greater DFI involvement in round two.

Tariffs and government support changes

The round two FIT offers $0.084 per kWh of electricity produced by solar photovoltaic plants between 20MW and 50MW in capacity and $0.078 per kWh for plants between 500KW and 20MW.

Lower tariffs could translate to thinner margins for sponsors, and the structures for projects being carried over into round two are likely to have to be rethought.

“Some of the previous bidders have approached us for potential financing albeit asking us to reduce our pricing to them given that the new tariff is considerably lower than phase one,” a source at the EBRD said.

Sponsors will need to study the revised power purchase agreement (PPA) conditions before making a decision, though “the tariff seems difficult to warrant the investment taking into consideration the associated cost for infrastructure, taxation, and so on” one developer told *IJGlobal*.

“The tariff depends on three components other than bankable PPA legal terms; cost of construction and operation; cost of debt; and our expected internal rate of return," the source said. "All three components must be reduced to meet the new tariffs. Lenders need to reduce their cost of lending through lower interest rates, lower contingencies, and guarantees."

Reducing debt costs may be difficult however because there's no improvement in terms of the risk profile or of the debt market, a source at the IFC said, and there are few levers to pull to reduce the cost. The lender was looking at 12 projects for round one, with debt tenors of 18 years.

"The only way to reduce the price is to lower the tenor to 15 years," the source commented, adding that some lenders were already offering "very low" debt prices for the first round and could be squeezed out if sponsors want to go lower.

"If sponsors want to lower the rate again it may be a problem for the general lender group," the source said. "Some of the lenders were already struggling with the prices. If you keep the same tenor and lower the price I suspect there will be lenders having difficulty with that, and some may drop off."

Round two also changes the support provided against currency exchange risk. Egypt's government has said the payment terms will offer 30% pegged at £E8.88 ($1) with the remainder pegged to the US dollar exchange at the time a payment is due. That compares to 15% at £E7.15 with 85% pegged to the dollar for round one.

The arbitration issue

Despite the lower tariff – which was expected by the market – a key feature of the second round is the progress made to sort out the issues lenders were having with arbitration.

DFIs struggled to lend on round one, as IJGlobal revealed in June 2016, due to Egypt's government wanting any potential arbitration concerning the projects to take place at the Cairo Regional Centre for International Commercial Arbitration.

The DFIs had argued that the project documents should specify any arbitration related to the projects would be held in a 'neutral' territory such as Geneva, Paris or London. When Cairo wouldn't budge, the DFIs dropped the projects.

Round two looks to fix this issue. Domestic arbitration will still be the standard for projects, but sponsors will have the option to appeal decisions with an international 'seat'.

"Our understanding of the arbitration is that the seat will only be moved offshore if one of the parties contests the onshore arbitration decision," the EBRD source said. "This will then obviously prolong the arbitration process."

Which developers are eligible?

In the first round, the government set a target of procuring 2GW of power. Once projects equaling that total had reached financial close, all subsequent projects would no longer receive the first round FIT rate.

Though this restriction has not been applied (the government will fall well short of the 2GW target by the 27 October financial close deadline), it is unclear whether a similar restriction will apply to round two. The second round is also understood to have a 2GW target.

Round two will be open only to those developers already prequalified under round one. If the full 2GW capacity limit is not awarded to existing participants in the programme, new developers will be permitted to scoop up any remaining capacity.

Round two developers must provide a commitment letter from foreign lenders by 28 April 2016 – just over six months after the round one October deadline. Financial close for round two projects must be achieved by 28 October 2017.

Egypt is also working to repair bridges with round one sponsors and will let them recuperate some £E220,000 in fees, according to a statement from Eversheds. They must request this payout prior to 26 October.

For now, the lenders are “waiting to see which of the phase one participants will want to roll-over to phase two,” according to one of the sources.