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Zero hour for European offshore wind

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Grid parity on German offshore wind has thrown a cat among the pigeons – possibly an albatross into the turbines – for the European renewable energy market and its ramifications look set to impact on a global basis. For now, the market is in disarray as governments seek to secure the best deal while delivering their green agendas, writes Angus Leslie Melville.

The repercussion of zero bids is first impacting the European market as politicians raise their hopes for scrapping subsidies for offshore wind in the wake of April's zero bids from DONG and EnBW for German projects – both for very different reasons.

The ramifications of this landmark being achieved are huge and well documented, but this week has seen an interesting development in the Netherlands.

The Dutch economics minister sent a letter to parliament to allow the country to cater for zero bids for its latest round of offshore wind projects. In this missive, he immediately cites the two instances in Germany – but fortunately recognises that there is no actual correlation between the two markets.

It was with great relief that we learn that Henk Kamp (in his letter) recognises timelines for the German projects – to be delivered in 2025 – vary greatly from Dutch ambitions to realise their projects sooner (2023). Further, it would appear that he understands that DONG is taking a punt on technology advances… not to mention that the wind resource is far greater in Germany, than off the west coast of the Netherlands.

His reason for doing this comes down to the wording of the current tender which effectively makes it impossible to win the tender if you submit a zero bid. Tender documents indicate that the permit will be awarded to the bidder that is awarded the subsidy – causing something of a conundrum for the Dutch government as zero bids are automatically disqualified.

There will now be two tenders staged this autumn – one that is open to zero bids and (should there be no zero bids, or the zero bids fail to meet qualifying criteria) it will then be followed by a more traditional tender and (dare I say) a Dutch auction.

Looking at the Dutch and German markets leads to comparisons being made. In Germany offshore wind farms receive a guaranteed market price, but they have no upside – or downside – whereas in Holland, you do take downside risk.

If you put in a bid for, say, €54/MWh and the electricity price rises above that, the wind farmer benefits from the upside. However, should energy prices falls below €54 there is security up to a point. There is a floor set at €30 and if the price of electricity falls below that level, it becomes a problem for the operator.

A tale of two utilities

The two zero bidders – DONG and EnBW – approach their zero bids from two very different positions.

The DONG position (intended) is that it has the luxury of time on its side. It has the better part of a decade to benefit from improved technology, a safe bet as turbines have improved steadily on an annual basis.

As for EnBW, it is also taking a punt on future technology… but as a utility that sits right at the top of the dirty league tables for its dependence on coal-fired thermal plants; its need to clean up its act is a driving force.

As one source said this week: "EnBW just has a major, bloody problem. It's an old, traditional, coal-burning utility and it's facing a lot of problems." This statement was shortly followed by guffaws and an unhealthy dose of schadenfreude.

Prices are coming down

It is a given that prices are heading south and genuine grid parity is on the horizon. So how is that going to impact the market? For a start, the market risk element in these projects has shot up.

Take a look back at Gemini which was bid at €169/MWh when market prices were around the €50 mark. At that level, the project was covered. However, prices in the Netherlands are now at €30-35 which is interesting when you consider that Shell/Eneco put in a bid of €54.50 for the 700MW Borssele 3 and 4 project.

The bottom line is that there's really not a lot of upside out there any more – added to which, you only have security for 15 years.

The plan for your common-or-garden offshore wind farm should be to recoup the lion's share of the investment in the early years, but at these prices that's not going to happen. As such, these projects are hugely exposed to market prices.

So the market risk element has gone through the roof and, it falls to those who can take a view on power markets to stay involved… which hugely impacts project finance and is very worrying for IJ readers. After all, lenders will not take a view on market pricing.

They can't. Banks need some form of contracted revenue and to have confidence in a project. And it's not just the lenders, it puts a lot of pressure on project finance investors too. Together they are going to have to find a solution – which doubtless they will do, but for now it's a tad worrying.

Utilities to the fore

To take a view that all offshore wind projects around Europe will fall to the likes of DONG and EnBW to be balance sheet financed is not realistic.

For one thing, the zero base leaves them 100% dependent on market prices and leads to the (wrong) assumption that only balance-sheet investors are capable of delivering offshore wind farms.

Take a look at DONG's business model. This is to recycle capital as it is a capital-intensive business, selling down after construction into a holdco structure.

It will be impossible to find another investor – say a pension fund – to step in and expect them to take a view on power pricing.

And looking at the European offshore wind energy pipeline, a tremendous amount of capital is required to deliver the MWs in planning. To assume that it will all be delivered on balance sheet by the utilities is lunacy.

This was the world we lived in prior to Belwind (2009), a world where offshore wind was delivered by utilities and nobody else.

Belwind brought to the table a non-utility equity structure with project finance and – more importantly – served as a turning point for the market as the utilities were stretched to breaking point on existing projects, hampered by an inability to use project finance as it would impact their ratings.

By allowing other players to become market participants, it spread risk understanding and perception which resulted in

more thorough analysis of the projects. The positive impact of this has been amazing. Due to the rigour of non-utility partners – banks primarily – projects are more thoroughly due diligenced and are nowadays being delivered way ahead of schedule.

This resulted in decreased costs which then resulted in lower feed-in tariffs and zero tariffs become a distant reality.

We are now at the stage where power price risk brings us square back to where we started with utilities dominating the space.

Where's the next Belwind when you need it?