

# Dumping deadlines

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On 24 November South Africa's Department of Energy is due to name the preferred bidders for the fourth round of its renewable energy independent power producer procurement (REIPPP) programme. The DoE is due to award 1,000MW of extra capacity primarily through utility scale wind farms and solar photovoltaic plants, but there are a number of reasons to suspect that the procurement will be delayed.

It will not be the first interruption to the REIPPP programme. The first round, which procured [1,416MW of new capacity over 28 projects](#), was widely praised but suffered numerous delays in its early stages due to land rights issues. After the round one deals were signed in late 2012, the government decided to stagger future procurement rounds so that only one set of deals would reach financial close each year, in an attempt to ease the burden on the DoE and state utility Eskom.

The second round deals reached financial close, after a minor delay of around a month, in mid-2013, and the [REIPPP programme appeared to be gaining some momentum](#). The projects were attracting increased interest from international investors and, as a result of the rising competition, tariff costs had fallen through the floor.

A year later and the outlook was looking less positive however. The [17 third round deals did not reach financial close on 30 July 2014](#) as scheduled, and the June deadline for the naming of preferred bidders on round 3.5 for concentrated solar power was also missed. Several months later, with no official update from the government on the progress of either of these two procurement rounds, it is no surprise that market observers are sceptical that round four bidders will be confirmed this month.

## **Eskom under pressure**

One developer told *IJGlobal* that they rated the chances of the round four deadline being met as around 50:50, while a lawyer advising on some of the projects said that "if developers have not yet had their instructions on it [from the DoE], it does not seem likely to happen".

The developers, lenders and contractors are all in place, but the government seems reluctant to sign off contracts at the speed the market would like. The major challenge facing the programme is transmission infrastructure, and the ability of Eskom to connect all of the awarded projects to the national grid on the timelines originally agreed to.

Eskom is trying to juggle a number of problems at once. South Africa has a reserve margin of less than 1% and with many of Eskom's power plant assets suffering performance issues, it has had to introduce managed blackouts to reduce demand. The state utility is also trying to manage a debt pile of around R255 billion, and was not aided on 11 November by Moody's decision to downgrade the company's rating to Ba1 (junk status). This decision immediately followed the downgrade of government debt to Baa2, just two notches above junk.

Eskom is currently negotiating a new funding plan with the government, and earlier this year asked for an equity

injection of around R55 billion. The government responded in September by promising R20 billion, dependent on the sale of non-core state assets.

New major state-funded power stations are being developed by Eskom, such as Medupi and Kusile, but they have suffered major delays and funding problems. The REIPPP programme is the quickest way for the government to get MWs onto the grid, but they are dependent on Eskom grid connections, which appear to have been impacted by budget cuts.

### **Constrained capacity**

According to sources, renewables developers for the third round have been told by Eskom that their commercial operation dates must be pushed back, in some case by years, before financial close can be agreed. These delays will increase contractor costs considerably for the developers, a particularly challenge for smaller, local sponsors without large balance sheets. The gap between original cost estimate letters at the time of procurement and the final budget quotes proffered by Eskom now is understood to be quite significant in some cases.

Many within the market agree that too many projects have been located in with strong wind and solar potential but lousy grid capacity, with the Northern Cape proving particularly popular with REIPPP developers. The challenges of trying to connect so many projects in areas with already constrained capacity is likely to lead to the DoE specifying areas for development in round five.

Several sponsors are also helpful that the government may turn away from a procurement process largely dictated by tariff price to one determined by other factors. Many are promoting the idea of a fixed tariff system, particularly for smaller scale developments, which would allow local developers to play on a more even play field with the larger utilities, which are beginning to dominate the programme.

“The traditional auction/bidding process, as successful as it has been, has got us to a point of diminishing returns particularly when we consider the cost and timing of grid connections”, said Davin Chown, director of Genesis Eco-Energy.

“Potentially South Africa could alleviate some of the increasing risk by introducing a fixed-tariff procurement system from Round 5 onwards but whatever the way forward, we need to do it in a way that enables us to connect to the grid in time and minimise the escalating connection costs.”

### **Currency concerns**

In the meantime Eskom will attempt to reach amicable agreements with third round developers on grid connection dates. The government has stated that unlike previous rounds where projects closed simultaneously, the third round closes will be staggered. Some are hopefully that some deals will be concluded before the end of the year. According to sources, despite the delays, and consequent cost implications, all of the round three developers are still ready to close.

Much may depend on the respective movements of the South African rand and the euro, with the government unlikely to sign on contracts which are less favourable for the government if the local currency is looking particularly weak on the 24<sup>th</sup>. Bids were made at a certain price, based on costs for foreign content such as turbine which are to be imported from abroad. These costs, often in euros, are effectively underwritten by the government through the state guarantee. And so, ultimately National Treasury may have the final say on whether the DoE misses another deadline.

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