FINANCIAL SECTOR: STATEMENT on RENEWABLE ENERGY

Attracting substantial finance and investment is a prerequisite for scaling up the development of renewable energy internationally. The challenge is to introduce the right policy frameworks and financial tools to enable renewable energy to achieve its market potential. This applies both to maturing renewable energy markets in the OECD, and is particularly important in developing countries, which have significant potential for both larger scale on-grid and small-scale off-grid investments, but where investment is put at risk from geo-political, economic and regulatory risks, and the lack of developed financial markets and products.

The following position statement summarises – from the finance sector's point of view - the key characteristics of government policy necessary to increase investor interest in renewable energy. It is based on consultation discussions among bankers, investors, insurers, and financial experts in the lead up to the Bonn International Conference for Renewable Energies in June 2004. In addition, the discussions raised matters for the finance sector itself to consider, including issues in the area of risk management, awareness raising & capacity building, and new financial products.

Core Policy Recommendations

Strength, clarity, and stability are decisive characteristics of the policy environment that attracts capital to renewable energy: that environment must be specific enough to improve the bankability of projects and provide conditions for steady market growth in the renewables sector. An effective policy framework must be 'loud, long, and legal':

- Loud – the signal to the market, through incentive structures or other means, needs to be 'loud' and clear to attract capital into the sector;
- Long – rules and incentives need to be stable and sustained for a duration that reflects the financing horizons of the projects;
- Legal – a legally-established regulatory framework based around binding targets or implementation mechanisms is needed to provide the basis for long-life capital-intensive investments.

It is important to note that at the early stage of development of the newer renewable energy technologies, supplementary incentives that support technology innovation are required in order to provide an environment that rewards entrepreneurial activity.

Additional Policy Considerations

* Existing energy subsidies are perceived as a problem in several markets as they make conventional energy costs artificially low, which disguises real costs, and conversely make it harder for renewable energy to become commercially competitive.

* Regional and international financial institutions (IFIs) should play an enhanced role in financing and attracting private capital to renewable energy in emerging markets. In tackling the scarcity of viable, bankable opportunities in this area, these institutions can lower development costs in early markets by providing seed and growth capital. By underwriting or otherwise mitigating political and regulatory risk, they can significantly reduce project costs.

* Local government is recognised as an important actor in the development of local renewable energy markets. Local governments can influence energy demand, use, and development in their jurisdictions through policy and purchasing, through their regulatory functions, and by expediting planning procedures – the last of which is important to reduce project development risk. Various public-private collaborations at local government level can lower project risk and mitigate the constraints of pre-investment costs.

* A framework which fosters local ownership, including manufacturing or assembling, can enhance commitment to renewable energy. Many emerging markets do not feel committed to technologies they do not own, not least for energy security reasons.

* A national policy and regulatory regime is necessary, but insufficient to tackle the issues of financing small-scale, off-grid, often remote renewable energy applications in less developed markets. In addition to an enhanced role for International Financial Institutions (IFIs) and regional development banks, and the development of local credit markets, public sector provision of small amounts of grant money and patient capital is seen as strategically important. There is a strong argument for a blend of grant and development finance funds, particularly where renewables-based projects are also serving poverty alleviation objectives.

Carbon Finance

Rising carbon values in the OECD and the scale up of OECD renewable energy markets with decreasing technology costs will contribute to renewable energy development in emerging markets. The addition of carbon finance alone, however, is currently seen as insufficient to make renewable energy profitable in most cases. Discussion is open as to whether or not it is possible to 'export' the subsidy that consumers are willing to pay in the industrialised world for renewable energy to developing countries through, for example, the creation of an international market for renewable energy.

Finance/Insurance Issues

Even within the maturing renewables markets, several gaps exist on the renewable energy financing and insurance 'continuum' between smaller, specialised finance players dealing mainly with project developers, and the major financial institutions seeking large scale opportunities in the renewables sector. There is also a gap in the insurance and risk-transfer market for innovative approaches and new products for renewable energy technologies, which because of their small scale have difficulties passing internal business hurdles.

The opportunity therefore arises for the public sector to work with the finance and insurance sectors to address these and other specific barriers: particularly where small amounts of seed money could make a significant difference in kick-starting the development of new tools and approaches.

Capacity

* Development of strong domestic credit markets for renewable energy is a necessary element in the financing chain to enable enterprises to access finance for renewable energy business activities. This requires capacity building in developing countries and improved information exchange in OECD countries.

* Fostering entrepreneurs: a more supportive environment for young enterprises is important to increase the stream of bankable renewable energy projects coming forward, including training in business development skills and local facilitation for accessing the right tier of finance.

Consultations

Consultations were held with European and European-based international banks, investors, and agencies in Basel, March 2004, organised by BASE for UNEP's Sustainable Energy Finance Initiative (SEFI); and with major banks, investors, and insurers in the City of London in April 2004, under the Renewable Energy and Energy Efficiency Partnership (REEEP). Consideration was given to both OECD and emerging markets. Financial experts from the wider REEEP international network were also consulted.

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Appendix

Experience with EU renewable energy incentive schemes

One roundtable with financiers in London, which focused on OECD renewable energy markets, discussed matters around the differing policy frameworks in Europe.

The finance sector has already gained important experience from dealing with the different policy and incentive systems in place in Europe. At present, these systems fall into two broad categories: fixed, or 'feed-in', tariffs operating in several countries, and the binding quota and trading ('renewable obligation certificate', ROC) market in the UK. Both systems raise useful questions; the more important point from a financing perspective is that a regime is chosen, and implemented in a stable way across the duration of project lifetime; and if any changes are made that these do not perversely damage existing renewable energy investments.

Issues around feed-in tariffs include: the fact that they encourage installations in resource-poor areas; don't overcome local planning complexities or the fact that national and local 'below the line' distortions in areas such as taxation still exist. However, fixed-tariffs provide strong price certainty for investors – reflected in the number of deals done, and have encouraged entrepreneurs and smaller scale investors to enter the market.

Issues around quota markets are illustrated by the UK ROC framework – a relatively new mechanism placing a binding obligation on suppliers to provide a quota of renewable energy: its relative sophistication means investors must take a view on future price, amongst other things, to arrive at the value of the ROC. These price uncertainties are tending to drive investment into the arena of parties that can both manage this risk and access the necessary level of capital: traditionally the bigger utilities. The ROC market is currently creating a strong incentive for mature and lower cost technologies – typically the wind sector – while additional support mechanisms, or formulae, may be needed for other technologies.

Good policy/market characteristics, from an investment perspective might offer:

- Solid basis for long-term contracts or a legal regime to secure revenue over 10-15 year period
- Conditions leading to big liquid markets, if using tradeable market incentives, with credible market players that can deliver the projects;
- Ensuring oligopoly or monopoly control of access is not a barrier and that network codes are consistent with a move to distributed and renewable generation;
- Implementing a clear process for the planning and approval of new power plants and generation, including a preference for renewable energy projects: a framework setting out a more uniform process, involving local planning authorities, would reduce development risk;
- An expedited process for tackling 'future' grid-infrastructure and investment matters such as balancing, security, distributed generation, to ensure these issues do not become a barrier to project investment and delivery;
- A strong compliance regime, where relevant, including penalties for non-delivery.