

The post-subsidy future for offshore wind

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A common criticism of offshore wind, that it is too expensive compared with other available renewable technologies, has been challenged by bidding on a tender in Germany last week which suggests the technology can be developed without subsidies.

The German government is running an auction for 1.55GW of new offshore wind capacity. [The results, announced last week](#), have ushered in a new era for the sector, after EnBW took the lion's share of the available capacity without asking for a subsidy.

In a statement confirming the win for its 900MW He Dreiht project, the German publically-listed utility said it believes it can finance, construct and operate the plant on the market rate for electricity alone.

Danish state utility DONG Energy is also understood to have won backing with zero-tariff bids for two projects, and a €60 per MWh bid for its Gode Wind 3 wind farm.

Unlike the previous fixed feed-in tariff system, which guaranteed fixed, long-term payments, bidders must now work out for themselves what amount of money is enough to sustain a project and provide adequate returns. In structuring their assumed costs, the utilities have taken a punt on future electricity prices and also on technology improving between now and 2021, when the projects will be built.

EnBW said on 13 April 2017 that "the assumptions regarding electricity prices that were used as the basis for our bid were set at a moderate level. The anticipated returns are considerably above our capital costs and thus remain attractive."

Lender caution

But relying on electricity prices may change lender appetite towards the sector. Managing director of BNP Paribas' European energy unit, Mark Muldowney told *IJGlobal* on 19 April: "From a lender perspective, you are [now] looking at wholly merchant projects. This will certainly reduce the number of lenders who will look at particular projects, as there are significant numbers of lenders who are very uncomfortable with any form of merchant risk.

"Others will be prepared to consider lending, at a lower level of gearing unless there is some form of contractual support via a PPA or similar. For these lenders the key question will be the long-term operating costs relative to the projected price of power."

Other market players are warning that building an offshore wind industry built on assumptions is both dangerous and likely to create distortions in the market. On 18 April, German wind lobby group BWE issued a statement expressing its concerns.

When the earlier feed-in tariff system "was used to secure project financing...the remuneration was based on the real

cost structures in the projects of the past years and was regularly re-steered,” BWE said.

But today, “suppliers are apparently under great pressure to compensate for the elimination of nuclear and fossil fuels by renewables. The expectations of, in particular, state shareholders result in a highly risk-oriented behaviour. The bidding offers are subject to a significantly higher stock market price and massive cost-cutting steps in the field of plant technology are assumed.”

Downwards trend

Physical conditions such as water depths, seabed conditions, wind speeds and plant availability all affect construction costs, but these variables aside, the industry has witnessed a drastic reduction in expected costs in a remarkably short period of time.

Only nine months ago, the €72.70 per MWh price with which DONG Energy won the Netherlands' [Borssele I and II tender](#) was a record low. Before that, a more typical cost per MWh was along the lines of DONG Energy's in-development Hornsea Project One, for example, which has an inflation-linked strike price of €176.38 per MWh.

And so this German auction is just the latest in a year of surprises for the sector. Market observers won't have to wait long to see the wider consequences of these zero-tariff bids: results will be due this summer for the UK's latest contract for difference auction. Bidding opened before the German results were announced, but sponsors and lenders will no doubt look to what the German market has achieved when making final investment decisions.

The next German offshore wind auction will take place on 1 April 2018, for 1.61GW of capacity. Felix Dinger of Norton Rose Fulbright's Hamburg office told *IJGlobal*, “The fact that all owners of existing projects that have not yet secured a tariff need to be successful in the 2018 auction is likely to put pressure on the auction in 2018.

“Whether the so far unsuccessful owners of existing projects can identify similar cost reduction potential in their projects as the successful bidders from this year's round obviously did will be crucial for the outcome of next year's auction. This is also likely to be true for future auctions for new projects in Germany, as well as other European projects. In addition the European regulators might take note of recent developments in Northern Europe, and now Germany, and adjust the different tender regimes in order to achieve equivalent low tariffs.”

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