

South Africa revamps REIPPP

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South Africa's renewable energy programme has been a significant success for a country which faces the looming threat of a sovereign downgrade and whose state utility has long been on the brink of bankruptcy.

The renewable energy independent power producer procurement (REIPPP) programme has tendered more than 6,000MW of new renewable energy capacity over four procurement rounds since 2012. Despite this success the South African government last week signalled a significant change in how renewables would be procured going forwards, with the cabinet approving the creation of Renewable Energy Development Zones (REDZ).

Eskom delays

The REDZ scheme is a reaction both to the success of REIPPP and the parallel struggles of state utility Eskom. South Africa's Department of Energy awarded 13 projects, with a combined 1,100MW of generating capacity, preferred bidder status in April 2015 as part of the fourth round of REIPPP. These projects were originally expected to reach financial close in early 2016 but have been delayed, primarily due to Eskom's financial woes.

Eskom is the sole offtaker for all independent power producer projects in the country. In October 2015 it confirmed that it would not be issuing any further budget quotes to new power projects until a resolution on tariff prices had been met with the National Energy Regulator of South Africa (Nersa). Without these budget quotes, new projects can't reach financial close.

Negotiations between Eskom and Nersa concluded on 5 February 2016, but no announcement on any deal has yet been made. Eskom had requested an 8.6% increase in power prices to help plug its cash shortfall. The increase is in addition to the 8% rise previously agreed for the time window running until March 2018.

Although many market participants would agree that South Africa should be moving towards more cost reflective tariffs, any price hike would be politically unpopular at a time of high unemployment across the country. The poor performance of Eskom make a further bail-out of the business even more unpopular.

The government has raised the prospect of at least a part privatisation of Eskom a number of times during the last year, which would likely improve its financial position and its performance. But any move would face significant opposition from unions and other powerful lobby groups opposed to strategic national assets being owned by the private sector.

Connection issues

The Department of Energy, to date, has taken little consideration to the location of projects when awarding projects in REIPPP. Price has been the primary criteria for whether an application is successful or not. The REDZ in this respect represent a shift in emphasis.

Developers have bid for projects which are located in locations with the best solar or wind potential, but this has led to a crowding of projects in areas like the Northern Cape. The grid network in these areas has not always been ready to assume a surge of intermittent renewable power, and Eskom has failed to upgrade the grid or provide connections in time to suit developers.

Many participants in the programme have talked about large discrepancies between grid connection dates offered by Eskom to developers post-financial close, compared to the speed of connection suggested at the bidding stage. This has significantly increased adviser and contractor fees for sponsors – a serious test of viability for projects with such thin margins due to the low tariff bids made.

The DoE started to address this problem with the so-called 'expedited round' launched in June 2015. This additional round was for any project, including those that had been unsuccessfully bid in previous rounds, which was able to connect to the grid quickly. It was launched in reaction to a deepening power shortage in the country, and was intended to procure more than 1,000MW of additional generation. These are the first projects in the REIPPP programme structured to transfer some of the grid connection risk to the private sector, easing some pressure on Eskom.

The REDZ are intended to aid Eskom further, by grouping future developments in specific areas where connection is easier. Observers say that the projects procured within REDZ will likely be of a larger scale than the projects procured through REIPPP to date.

Continuing concerns

Many market participants see a sovereign downgrade for South Africa to junk status as almost inevitable now, though the government is keen to do whatever it can to avoid this scenario. Though any downgrade for government debt would be matched by a downgrade of Eskom, companies will have already factored this into their model and it should not have a larger detrimental effect on new projects in the programme.

A bigger test for the market will be appetite in the secondary market for existing renewables assets. SunEdison is understood to be selling its projects awarded in the fourth round, and other developers such as BioTherm Energy are also looking to offload assets. The increasingly small pool of successful developers in the REIPPP tenders have been forced into bidding lower and lower tariffs to win mandates, but it is yet to be seen if there is a wider appetite for these projects at these prices.

Some had hoped that local pension funds and asset managers would acquire a lot of the REIPPP projects once they were operational. But with sovereign debt around the region providing much better returns, without the need for active management, the incentives do not yet appear to be there to entice them.

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