COOPERATION FOR RENEWABLE ENERGY SOURCES: THE COORDINATION FUND

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1. BACKGROUND AND OBJECTIVES

Key issues to bear in mind ("critical considerations"):

- **Global warming and climate sustainability**: need to mitigate GHG emissions.
- **Oil dependence vs. "abundant" and "0 cost" sources of energy** (sun, wind…): growing RES demand.

Thus, **emphasis** on RES to be put **on benefits**, not (only) on costs!. Moreover:

- Technological evolution drives **costs down**.
- Technology transfer (and financing) from EU countries will certainly encourage economic **growth** and **employment** in third countries (MENA, Balkans or other regions).
- The more projects developed in many different countries, the **lower is the risk**.

Projects are successfully developed **when** made **"bankable".** Thus, any initiative to develop RES under a mechanism within the EU or between the EU and third countries must be based on:

2. KEY ISSUES FOR THE SUCCESS OF THE CF

- **Political willingness**: a common understanding and acceptance of above goals (and benefits) by the EU and third countries.

- An institutional and legal **framework** to create a **market** (to encourage the participation of both industry and commercial financial institutions) with a clear and stable framework for the long term.

- EU political willingness to create and financially support a **pan-European managing entity:** Let us call it "**The Coordination Fund**" (*CF* hereinafter) in order to:
  - Become the **off-taker** of the output: Manage a RE system where producers will be established in third countries with their clients in the EU.
  - Put in connection players (generators, traders, retailers…).
  - Assure financing under a Project Finance scheme, which is a must for RE projects because the need for long term commitments for buying and selling electricity (under PPA, feed in tariffs or similar schemes).

Thus, we identify the CF as key player is crucial for the success of this initiative.

3. KEY CONSTRAINTS AND WAYS TO OVERCOME

A large portion of the amount to be invested (financed) ideally should come from **private sector** (banking market or capital markets), such as:

- Commercial Banks.
- Investment funds (Wealth Funds, Pension Funds, Insurance companies, etc).
- Private equity and venture capital.

Any of above investors will face following main **constraints** when financing RES projects:

- **Cost gap**: derived from what is needed to repay investment costs of RES vs. fossil fuel. However, this gap is under a decreasing trend.
- **Risk** assessment of projects in non-EU countries.
- **Commercial banks**: currently offering short tenors and high prices (derived from economic crisis, future bank regulation and Basel III).

3. KEY CONSTRAINTS AND WAYS TO OVERCOME

Above key constraints may be overcame by considering **several financial instruments** (as alternative or complementary tools) to complete funding which may come from multilateral institutions:

- **Project Finance**:

  Concessional long term with limited recourse loans under a risk-sharing/mitigating mechanisms. If commercial banks do not reach desirable tenors or pricing, support mechanism from multilaterals to be fully used (e.g. long term tranches of debt, credit guarantees, irrevocable buying offers to buy debt at maturity, contingent credit lines, grants and/or bank´s subordinated debt).

- **Project Bonds**:

  Attract long-term investors on large infrastructure projects from Capital markets. If necessary, supported by multilaterals (e.g. full-wrap or partial credit guarantees).

- **Securitization** of GECs (Green Electricity Certificates):

  The *CF* should also be able to trade the GECs in a liquid market.

4. CF STRUCTURE AND MAIN FUNCTIONS

In order to manage the complex scheme of interrelations while becoming credible and obtaining **best market perception** and **minimum risk premium**, the *CF* must be:

- Financially strong (credit rating "A" or higher), since it will be the purchaser of RES output.
- Under a clear and stable framework.
- Owned or with a strong public endorsement by EU Member States.

In order to ensure the correct operating of the new market, among other functions, the *CF* must be ready to **promote and coordinate:**

1) Agreements for investment and development of RES in third countries and interconnection with EU.
2) PPP (and/or any other form of collaboration between private and public agents), to define requirements for RES projects generation.
3) Financing of RES projects, by facilitating several forms of financing and guarantees schemes.
4) Auctions and long term contracts for RE producers + trading with output generated (RE and GECs).
5) Political Risk coverage (facilitating MIGA and ECA´s involvement).
6) Fiscal regulations / incentives (local and EU level) to encourage investment.
7) Relations (role of intermediary between authorities, generators, distributors and traders) from EU and third countries.

4. CF STRUCTURE AND MAIN FUNCTIONS

8) Long term contracts (20-30 years), ensuring a revenues stream coming as a result of a bid, so *CF* sets a either a maximum price for PPA or a FIT (feed in tariff) during the term of the contracts, and tenderers bid a discount over it. Thus, under these contracts, the *CF* will:
   - Become the off-taker of PPAs (thus, becoming the owner of the output and future manager of highly valuable assets).
   - Sell electricity in EU (either to traders or directly to retailers at market price).

Note that, since bidding prices from concessionaires will be above market price, the CF will bear a **negative cash-flow** (up to the moment when both prices matches). This initial deficit will be compensated with **future surplus** at the end of the PPAs (once RES plants have been completely paid for), which will be derived from:

- RES generators retain an option to extend their projects period when maturity is reached, made effective by paying an "option price" (= negative cash-flow bear + interests) to *CF*.

- *CF* has an option to become the owner of the projects, taking advantage of an asset completely paid (debt fully amortized) but in operation, thus **inheriting very valuable assets**.

5. CREATING AND OPERATING A NEW EU-THIRD COUNTRIES RES MARKET

For a new EU-third countries RES market, two **sources of income** may be considered, which extend (at least) to the same period of the financing.

These sources of income will be managed by the *CF,* which will take the role of a **link** between generators (auction bidders winners) and rest of players (distributors, traders and/or retailers):

A) **Green electricity trade**: CF buys from RE generators, and sells this output as:

- Local sale: to traders/retailers in the domestic market in the country of origin.
- Foreign sale: to traders/retailers in the country of destination (EU).

B) **Certificates market**: CF **discount** certificates from RE generators:

- GECs to be traded in the “EU markets”, so electricity retailers can comply with their % of green electricity in their sales according to 2020 objectives.
- CERs (CO2 certificates), if projects fall under Clean Development Mechanism scheme**.**

5. CREATING & OPERATING A NEW EU-THIRD COUNTRIES RES MARKET

According to this, the following kind of **contracts** should be developed:

- Between **Generators** and or through the CF:
  - ✓ PPA (Power Purchase Agreements) for buying green electricity production.
  - ✓ GEC securitization, rights to be acquire by CF, then traded to retailers or other players.

- Between the CF and electricity **TSO** (Transmission System Operators): PTCH (Power Transmission Capacity Hiring) contracts. Let us remark the potential future congestion derived from international connection.

- Between the CF and **Traders**: green electricity for trader´s compliance with the annual goal determined in RE Action Plan for green electricity consumption.

- Between the CF and **Retailers** / **DSO** (Distribution System Operators**,** willing to comply with green electricity quotas in their sales): long term GECs purchase contracts.

6. CHART AND DISCUSSION