Financing solar projects in the MENA:
2017 and beyond

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Bid, Win and Develop Cash Rich Projects in MENA

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Introduction

The growing competititveness of renewable energy against hydrocarbons in the Middle East and North Africa (MENA) has attracted great capital flows into new solar projects over the past few years.

Today, the region is witnessing first-of-their kind financing initiatives including the $27 billion Dubai Green Fund, which promsies to offer easy loans for investors at reduced interest rates; Green Deal Dubai, the MENA's first cleantech crowdsourcing platform; and Morocco's issuance of the country's first green bond to help finance Noor PV 1 project.

At the same time, local and regional commercial banks are becoming increasingly comfortable with funding solar projects, despite the technology being new to their portfolios. As we move into 2017, what can the solar industry expect from the financing community and what de-risking strategies would be beneficial to all sides? We speak with three financial experts in the MENA region to find out their perspectives.

Frank Wouters

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Which type of projects are being funded nowadays and what did they get right?

A number of solar PV and CSP projects are currently being developed, funded and built across the MENA region. They all obtained attractive financing packages, leading to competitive, low tariffs. The main vector in achieving low cost finance is the quality of the off-taker. The higher the quality, the lower the risk.

In case the off-taker is a double A-rated government such as in Dubai or Abu Dhabi, financing is available from local and international sources at very competitive conditions. We have seen that this can lead to record-low prices for solar PV electricity. Another contributing positive factor is that the UAE Dirham is pegged to the US Dollar. In other countries with good solar resource such as Jordan, Egypt and Morocco, credit enhancement provided by multilateral banks can lead to similar results.

Which financing models are being pursued for solar projects in the region?

In the recent past we have seen an emergence of the IPP model, which is sometimes structured as a PPP, whereby the local utility takes an important stake in the project. The pure EPC model, where the incumbent utility procures a plant from the market, invests in it and runs it, is less and less common. Inviting IPPs into the market increases competition and leads to lower cost for the system. In terms of funding, most of these projects are then project financed. Credit enhancement may be required, depending on the risk profile of the off-taker.

What will be the biggest risks to solar investment in the short term?

Investors and banks appreciate certainty. In some cases, especially when a country was new to the game and learning how to procure large-scale solar, rules were in flux during a procurement process. This should be avoided, since it may lead to loss of confidence by the investor community, and will lead to higher risk margins and higher tariffs.

Which de-risking strategy, if more broadly applied, will bring the biggest benefit to the MENA solar industry?

The mantra of TLC applies. Transparency, Longevity and Certainty of policy measures and structures are crucial. This means that the process to procure power needs to be crystal clear from the outset. Policies should be long-lived, and investors need to be guaranteed that whichever framework there is will survive the process, and of course the contractual period.

Looking ahead, what financing innovations are you looking forward to seeing?

We're seeing a number of exciting innovations in finance on a global scale, and it would be great to see them in the MENA region. Firstly, green bonds could be an interesting vehicle to spur investments in renewable energy in the region. Secondly, there is a growing portfolio of climate finance options available, including the Green Climate Fund, that could help spur investments.

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How is Natixis involved in renewable energy project financing in the region?

In the MENA region, Natixis has been to date active in renewable energy project financing primarily in the UAE. We were Documentation Bank and original MLA for the financing of Shams One Solar – a 110 MW CSP project in Abu Dhabi – and intend to play a lead role in the senior financing of the third phase of DEWA's Solar programme (PV project of 800MWs) in Dubai. We're also well positioned on the Sweihan solar PV tender in Abu Dhabi, with credit approved commitments allowing us to act as Lead Bank for two of the bidding consortia.

We will naturally aim at supporting bidders and developers for the upcoming DEWA CSP tenders. Given our extensive renewable experience globally, we will generally look at all renewables initiatives in the GCC. SEC has just launched in Saudi Arabia its tender for 80 + 20 MWs PV plants, OPWP is considering in Oman solar projects developed under their well-established IPP model and Qatar is eyeing a 1,000 MW solar park: given the solar potential of the GCC, we believe that all those projects will fuel the diversification efforts of the GCC countries and we hope to help those countries meet their renewable targets.

Outside the GCC, Morocco and Jordan have both been interesting places in recent years for renewable energy (solar and wind), but the financing has been mostly backed by multilaterals and local banks.

What funding strategies are being pursued for solar projects in the MENA region and how are these evolving?

Renewable energy projects in the MENA region are mostly backed by long-term PPAs with strong government-owned monopolistic utilities. This provides a significant level of comfort on the long-term, and enables these projects to benefit from favorable leverage either through long-term amortizing debt or soft mini perm structures (allowing developers to benefit from the upside created by re-leverage following the de-risking post completion).

These financing options are provided by commercial banks in most countries, and by multilaterals in Jordan and Morocco. We expect these structures to be utilized in the region in the near future. Egypt is developing its renewable power generation capacity with a Feed-in-Tariff program. Whilst such program may be adequate to launch renewable initiatives, the underlying regulatory risk has probably not supported the bankability of those projects, especially when combined with the currency issues of the country.

Can we expect to see more complex funding strategies?

The IPP model is still successful in unlocking long-term bank liquidity and we are not expecting changes in the short-term, until a sizeable and transparent wholesale electricity market is established. Nevertheless, incrementing regulatory constraints are leading most banks to incentivize developers to refinance the original debt package well before contractual terms, with requirements for cash sweeps and penal interest rates after an initial short-term period.

In order to still be able to provide long-term funding to our clients, Natixis has developed a series of partnership agreements with Asian pension funds/life insurance companies, which have the ability to fund projects alongside Natixis as senior lenders. This arrangement provides our clients access to Fixed Rate financing, which enables an easier implementation of interest rate hedging requirements. We also believe that solar PV in particular could be refinanced in the debt capital markets following the construction period and we expect this activity to pick up once assets are more mature.

How can projects in the MENA region be more competitively developed?

PPAs and tenders are probably the most efficient mean to secure the most competitive tariff at a certain given time. On the other hand, 25-year PPAs signed in the 2000s for projects with less efficient technologies are still valid.

Whilst this approach has proven to be very successful to procure the base load energy requirements, one could expect that certain countries may wish to promote power market auctions for any added energy requirements, which would lead to innovative financing structure mitigating electricity price risk. This is the approach that OPWP has considered for some time now, but a few challenges still need to be addressed before rolling out auctions.

A number of power developers are also reaching a critical mass of electricity generation projects to start considering monetizing specific portfolio of operating assets brought together. This will certainly help accessing new class of investors, and most notably debt capital market.

Which will be the biggest risks to solar-project financing in the near term?

From a technical perspective, PV financing will be quite straightforward as long as the risk of operating these assets in harsh conditions characteristic of the region is adequately addressed. We expect developers and supplier to rapidly adapt to the weather conditions in the MENA region as we have previously observed in say, the south of Spain or in Latam.

CSP financing will be more challenging though as the technology keeps evolving with extensive due diligence to be carried out for each transaction. For that reason, the banking universe is probably not as wide as for PV financing.

Regulatory risk is also something NATIXIS has been carefully assessing on each transaction. In particular, the positive aspect of tenders in the region is that project development risk is minimized and coupled with competitive bidding; this has resulted in record low tariffs for renewables in the region and in fact, the world.

We expect some upheavals though in the module supplier segment due to the fall in margins, but, we believe that the sector is resilient as was observed during the last down cycle in 2011. The challenge, however, is to ensure that equity returns remain sustainable enough to support further investment in such assets.

Which de-risking strategy, if more broadly applied, will bring the biggest benefit to the MENA solar industry?

Energy subsidy reforms needs to be implemented in countries that have not formalized yet such reforms, in order to keep evidencing the economic rationale for energy projects. Attracting new types of investors would also help developing a mutually beneficial competition amongst various funders of solar projects.

The refinancing of Shuweihat 2 IWPP in Abu Dhabi initially aimed in 2013 at promoting access to the debt capital market, but this refinancing closed at a time where bank liquidity was still abundant and cheap. The bond market is now much more familiar with the GCC than it was at the time of this refinancing, with an increasing track-record of sovereign and corporate bond issuances, and given the current bank market conditions, less favorable than a few years ago, a focus on attracting DCM [debt capital markets] funding would greatly support solar-energy financing in the MENA region.

What solar-financing models are you looking forward to seeing in the region?

The disparity of electricity generation capacity and consumption at a certain time of the day amongst MENA countries is an incredible opportunity. Political challenges set aside, cross-border initiatives combined with energy storage development would ensure the best use of energy resources. Saudi Arabia and Egypt have already agreed on an electricity export/import scheme addressing this difference in peak load hours. And as electricity exports within the already established Gulf Cooperation Council Interconnection Authority keep growing, the possibility to establish a credible power market will be more probable.

Paul Van Son

*Chairman, MENA & Turkey at **Innogy/RWE** and President at **Dii***

How is Innogy involved in the MENA's solar energy sector?

We develop small and large size solar projects and are involved in tenders in the region

What most common funding strategies are being used in the region today?

Most of the projects in the region are based on project finance, in which we keep a certain equity stake. Occasionally we are involved in public-private partnerships. One may expect increased sophistication, e.g. to reflect special local conditions such as country risks, financial innovations or to respond to changes in the capital markets.

In your opinion, how can projects be more competitively funded?

The best thing is a 'no nonsense', fully transparent and fair tendering process with clear commitments from competing parties in a credible and stable environment. Good examples can be found lately in Morocco and UAE.

Which do you believe are the biggest risks to financing in the region's solar industry?

Intransparency and changing (business case or contract critical) conditions are the biggest risks both short and long term. Such risks may include political unrest, retroactive reduction of support, and available grid capacity.

How are financiers and insurers underwriting the risk in the region?

Stakeholders develop approaches that fit to their business models. Mind that the region used to be out of scope for most potential foreign financiers, investors and insurers. Recently careful first steps are being made by courageous parties to enter into the MENA market. Parties may try first projects with a bit more relaxed approach, giving it advantage of the doubt or keep on requiring low risk-return profile.