Privcap/ Report

Q4 2019

HOW CORPORATES ARE GOING GREEN

The Rise of Renewable Power-Purchase Agreements

With Expert Commentary From:

Mike Hayes, KPMG
Wafa Jafri, KPMG

SPONSORED BY KPMG

The Rise of Renewable Power-Purchase Agreements

Far from witnessing "doom and gloom" around climate change, two leaders in renewable energy at KPMG are working with corporations around the world to transfer from "brown energy" to green. The shift is starting with Corporate Power Purchase Agreements (CPPAs) whereby massive consumers of energy contract with renewable suppliers for direct access to green energy. Not only are these agreements carbon-free, they are less expensive than the business as usual models. The interview also includes commentary on the challenges of structuring CPPAs, the institutional investors eager to finance them, and the broader corporate movement toward a carbon-neutral world.

Privcap: Michael, can you set the stage for us? Why is it important to understand this move to green energy and the importance of corporate power-purchase agreements?

Mike Hayes, KPMG: Everywhere you look across the renewable energy sector these days, you will see references to corporate PPAs. It is becoming very evident that this is now becoming a major trend across the markets. It's a really important solution for developers of renewable projects - whether it's wind, solar, biomass - that they now look to corporate PPAs as a potential market solution.

However, if you're a large corporation, it's very easy to say that you're going to convert to 100% renewable energy usage over the next five years. Actually doing it is a much more challenging thing. And that is the reason why large corporations reach out to people like Wafa and myself to help them.

Wafa Jafri, KPMG: Corporate PPAs have become a huge buzz and it's driven by two key factors: One is around sustainability and the second is around the cost reduction potential that renewable corporate PPAs can offer.

Hayes: We're used to hearing about the power and utility companies and the oil and gas companies who embrace the energy transition. I would refer people to also look at statements from organizations like BNP Paribas, HSBC, Banco Santander—and other financial institutions around the world have embraced this. We're seeing the petrochemical companies going on this journey. I would also add mining companies, petrochemical cement companies. Ultimately any company that really wants to do something proactive in the de-carbonization space will think about this solution. One of the challenges that we're going to see actually is whether the industry itself can produce enough new renewable energy and wind and solar projects quickly enough to actually meet this growing corporate demand.

Jafri: Given where we are in the energy transition, renewables actually offer a cheaper solution than business as usual—importing from the grid. So we are at a point in the energy transition where the renewable solution is actually cheaper than brown power.

Hayes: A corporate PPA also delivers certainty in terms of their energy price. Budgeting is a really important point for corporates. It's one of the key factors that's driving this agenda. Over the next 5 to 10 years, it is going to change the landscape for renewables. Wafa, I'd be interested in your thoughts about what this means for investors?

Jafri: There's a lot of interest from investors in this space. Subsidies for renewable energy are declining because it's able to compete with the conventional generation space. Renewable developers and investors are looking for a subsidy-free model.

↓ CONTINUES ON NEXT PAGE

Having a corporate be the off-taker from a solar or a wind farm is absolutely great both because it is driving down the cost and delivering better results for society.

Hayes: With governments and businesses responding to the growing public pressure to reverse ecological degradation, the sustainable investment market including investment in low carbon technologies has grown by nearly a third in two years. Global institutional capital is increasingly looking into renewable energy sector opportunities, boosting competition and maturity of the sector. Furthermore, a distinct and attractive group of environmental equity and debt investors has also emerged driving investments into renewable energy.

Too Few Deals

Hayes: I've been in renewables for the last 20 years. When I started off in renewables our biggest challenge was to find investors interested in getting involved and understanding this market. Without doubt, over the subsequent 15 years, we have traveled this bridge many, many times because investors now see the possibilities and the types of financial returns that were available from renewables. Today they cannot get enough of renewables. Our problem in the market today is there's too much money chasing too few deals. The reason for that is exactly the point that Wafa has made - from the developer perspective, the corporates tend to be very good counter-parties. The banks are very happy because there is a good counter-party actually paying for the power over 10 to 15 years. If you can get a contracted solution for the first 10 to 12 years of a project, investors are prepared to take merchant risk in the tail period after that.

Privcap: I would imagine that with the long-term contracts that are associated with these renewable development projects, they would appeal to investors who have an infrastructure investment mindset. There's so much visibility into future cash flows. And perhaps it's less of an equity-upside type of investment profile.

Hayes: Private equity is looking for a certain type of return - typically in the mid teens - and are prepared to take a certain amount of risk for that. Renewables doesn't really work that way. As you correctly state, renewables is really a product that's more appropriate for long term institutional investors. And we've seen the big pension funds, and the big life insurance funds, come into this market and dominate the market in recent years because they liked the fact that in some cases, there's a very good counter party and a lot of certainty. Wafa, we've spoken a lot in this session about what's going on in the wider market and how much corporates are turning to corporate PPAs as a solution to their de-carbonization or their greening needs, if you want to call it that. But as you and I know, it's not as simple as that. There are a lot of considerations that you need to take into account if you're going to pursue this type of strategy.

Jafri: Having the pleasure of working with corporates around the world on these, on helping them acquire renewable PPAs, has not been easy for three reasons. One would be around the market and regulatory framework. In our experience, local market regulation can prohibit certain contractual structures and asset arrangements.

The second one would be around the economic considerations, specifically around risk allocation of signing up to a long term contract. Macro-economic factors can affect the durability of financial impact. Careful consideration of local economic fragility and potential impact of foreseeable events can radically change the magnitude and distribution of optimal investments.

The third would be around accounting implications. With the introduction of IFRS 16, certain potential solutions could be considered an operating lease and require an asset and liability to be recognized on the balance.

Hayes: And that's why making a statement to say you're going to convert to a hundred percent renewables is great. But actually, to achieve that ambition, you need to go into a whole host of different markets with the different types of regulatory regimes and the different types of market structures.

Jafri: Furthermore, you must take into account risk allocation. How do you manage the demand profile of a corporate consumption profile against that of intermittent generation? And how do you actually make sure that there is enough energy to provide security of supply to that corporate? We are seeing more and more innovative commercial structures whereby trading companies or even financial institutions are taking on the risk of providing that balance of power.

Hayes: A lot of corporations are going to say, "We want power delivered 24/7." And that doesn't necessarily work with the solar or wind plants which would deliver green power sometimes, but not all of the time. And people forget that there's a big gap to be dealt with in the structure. But thankfully there's a whole range of corporate solutions, whether you use trading companies, whether you use storage or something else. But a key part of the work and the value I think that we bring to clients when we work with them on designing these corporate PPA structures is: how best and how cost efficiently we can meet that shaping requirement.

↓ CONTINUES ON NEXT PAGE

Accounting Treatment

Hayes: Commercially, we need to design a corporate PPA transaction in a way that delivers power to one customer with as much certainty as possible. However, when when the accounting people start to look at that, they say, "Hey, that now looks like the renewable asset, nominally owned by the developer, should be on the balance sheet of the off-taker, which is the corporate."

Jafri: We wouldn't really be accountants if you didn't mention IFRS 16, right?

Hayes: And certainly anybody who has the pleasure of working on corporate PPA transactions has the unenviable joy of having to read IFRS 16 and actually understanding it. It goes with the territory.

I want to turn the discussion to a slightly different area - the shareholder agenda informed by ESG and the principles of responsible investment. They are looking at corporates and saying, "We are not going to invest in the corporates unless they understand and embrace these issues and do something about it." So corporates now coming to KPMG firms are saying, "Help us to implement de-carbonization solutions."

Jafri: It is more difficult to implement a corporate PPA approach, but corporates would do that in order to meet their wider impact commitment.

Hayes: One of the reasons I'm so passionate about this is that there is a lot of commentary publicly about climate change and how governments are doing nothing about it. I have a slightly different perspective. First of all, I think if we're going to rely just on government to solve climate change, we're not going to get anywhere. We shouldn't spend our lives waiting for governments to adopt policies. We're not talking about how serious or how bad climate change is. We get that. What we're talking about here is that there's something meaningful and differentiating that can be done to tackle the problem.

From a KPMG perspective, these are the messages we're taken to our firms' corporate clients around the world. It's fantastic for us to see how corporates respond. Some of them are well ahead of us. They're working on new technologies, new processes. They're informing and educating their own people. There's plenty of gloom and doom about the seriousness of climate change. But Wafa and I happen to be lucky enough to inhabit a world where actually people are doing something about it. ■

About the Experts

Mike Hayes
Global Renewables Leader and National Sector Leader, Renewables & Sustainability
KPMG

Michael (Mike) advises clients in the Renewable Energy, Infrastructure and Asset Management sectors (principally Alternative Investments) and is the Global Lead for Renewables in KPMG. Michael advises clients on all aspects of renewables including developers, utilities and financial investors. He is also working with global corporations to develop decarbonisation solutions for their businesses. Mike is also working in collaboration with the World Economic Forum to develop transformative solutions to tackle the whole area of sustainable energy innovation.

Wafa Jafri
Director of Power & Utilities and Deal Advisory
KPMG

Wafa has over 10 years of experience as ENR Deal Strategy expert who is currently advising a large Integrated O&G company decarbonise their existing operations through procurement of renewable energy. She has worked with large Corporates (including HS2) on their energy procurement strategies. She has significant experience in advising clients on their power and gas strategy and execution of their vision based on her experience of working in different energy markets (Europe, Asia, US, Latin America, West Africa and Australia).

Listen to the full podcast at Privcap.com

How Corporates are Going Green:
The Rise of Renewable Power-Purchase Agreements