

RW Blears



All Change in the Clean Energy Market

“Invest, invest, invest.” That is the new mantra that will see Britain transformed into the fastest growing economy in the G7 (© K.Starmer). We’ll see. But there can be no doubt that renewable energy is going to be one of the prime sectors of the economy that will benefit from a ramp-up in capital investment. And this could present an opportunity for tax-free returns for High Net Worth Individuals.

Back in April, *Viewpoints* raised concerns about the state of the national wind generation sector in the UK. There was too slow progress towards meeting the Government’s goal of the UK having 50 GW of wind generation capacity by 2030. There had been an almost total block on new onshore wind development since 2015. At the same time, offshore development had been badly hit, both by supply chain inflation and by a serious misstep in the setting of the Administrative Strike Price (“**ASP**”) for the 2023 fifth round of the annual Contracts for Differences (“**CfD**”) Auctions. This is the process by which a price is set for developers’ electricity: the Government underwrites the developer’s price if the wholesale price is below the strike price and the developer refunds the excess if the wholesale price exceeds the strike price. In the 2023 round, the Government set the ASP (the maximum that it would pay under the auction process) at such a low level that there were no bids at all for wind projects.

A New Era for Renewables

We previously suggested that a change of government would see a change in the prospects for national wind development and that has proved to be the case. Ed Miliband's first move as Energy Secretary was to remove the planning restrictions which had effectively prevented the approval of any new onshore wind developments. Onshore is less costly and more straightforward than offshore¹, so we can expect to see a revival in consents for new onshore wind farms. Many of those will be at new locations. But some of the earliest wind farms are now coming towards the end of their useful life. They were built 25 years ago and the technology has advanced rapidly in the interim. Much larger, and exponentially more efficient, turbines are now commonplace. So, applications for bigger turbines on existing sites are likely to be a feature of the next phase of onshore wind development.

The Great British Energy Bill has been introduced into Parliament to set up the eponymously named 'Great British Energy' (one of the less confident traits that the new Government has retained from its predecessor is the hubristic tendency to label everything to do with the country "Great"). The new company will have a wide-ranging scope and the actual deployment of its intended £8.3 billion funding over the life of the current parliament has still to evolve. One of its three initial priorities is to scale and accelerate the roll-out of existing mature technologies such as wind, solar and nuclear.

Success at the Auction

A first fruit of the new approach has been the sixth round of CfD auctions. A budget of £1.026 million had been allocated for this in March. This was increased by £500 million by the new Government. The auction produced good results, announced at the beginning of September. A total of one hundred and thirty-one projects were successful with £9.6 billion being allocated, a very large increase over the result of the fifth auction round (AR5). Within this there has been an increase to 4.9 GW of agreements for new offshore wind capacity. There was strong competition and bids were awarded at a strike price which seemed unlikely earlier in the year. At £58.87 per MWh for new projects, the strike price achieved was a full 19% below the ASP. Interestingly, this was despite earlier industry concerns that the £73 ASP might actually be too low to generate the level of interest hoped for. Confusingly, these figures are in 2012 prices but the effect is that it is close to the current wholesale market price, at today's equivalent of £82.17 per MWh.

The previous administration had relaxed its opposition to onshore wind to the extent of allowing it to be included in CfD auctions. A total of twenty-one onshore projects were sanctioned. It was a similar story for solar. Ninety-three projects with a record total capacity of 3.3 GW were awarded support. Again, the strike price was a full 18% below the ASP.

It can fairly be concluded that the latest auction round was as successful as could reasonably have been hoped for. Investor confidence returned after the debacle of AR5. Developers across the range of renewable technologies made large numbers of bids at prices no higher than the current market

¹ International Renewable Energy Agency: Renewable Power Generation Costs in 2023. Link here https://www.irena.org/-/media/Files/IRENA/Agency/Publication/2024/Sep/IRENA_Renewable_power_generation_costs_in_2023.pdf

price. If developed, they will provide a major boost to renewables capacity without imposing a higher cost. Prices cannot go down for ever but technological advances and economies of scale have made solar and wind generation ever more competitive.

Aiming High

The new Government's target is to double onshore wind generation and quadruple offshore wind generation by 2030 as the cornerstone of its plan to wholly decarbonise the electricity generation sector by 2030. Solar generation is also planned to triple by 2030. These targets, underscored by an Energy Secretary and a government that are showing a revitalised commitment to renewables, present a big opportunity for investors. And there is more to come because most informed commentators believe that there will need to be a substantial step up in the pace of installation of new capacity². According to Cornwall Insight, if the goal of decarbonising electricity generation by 2030 is to be achieved, solar and wind will need to account for 67% of generation, but current projections suggest that only 44% will be reached as things stand³. That 67% is a stretch target but there will certainly be a determined effort in that direction.

But the garden is not entirely filled with roses. There are a number of obstacles which will stand in the way of the rapid scaling up of renewables capacity. Three principal ones are (a) grid infrastructure, (b) supply chain constraints and (c) finance.

Upgrading the Grid

Grid infrastructure is under great pressure. In the past, large fossil fuel power stations provided a one way energy supply across a long established, but now aging, network. Those stations could easily increase or reduce their output. Renewable energy, supplied on an intermittent and fluctuating basis, depends on the weather and is more difficult to manage. It is supplied through a plethora of new (many of them much smaller) facilities located in different areas. Each of these will require a grid connection. But there is currently an enormous delay, with Parliament's Environmental Audit Committee finding earlier this year that waits of 12-14 years were being experienced⁴. Throw into this mix the opposition of local groups to new infrastructure, especially pylons bringing offshore wind power to where it is needed, and there is every prospect of plans being thrown off course by this bottleneck. Chancellor Rachel Reeves' budget speech suggests that this problem is recognised, even if there was no great clarity yet as to how to resolve it. She said that the Government is working with the (new) National Energy System Operator ("**NESO**") to develop a "robust grid connection" process.

² "What are the implications of the Allocation Round 6 results?" by Joseff Reed, Brevia Consulting, 4 September 2024. Link here <https://www.brevia.co.uk/news/energy/what-are-the-implications-of-the-allocation-round-6-results/>

³ "Solar and wind to account for just 44% of power generation by 2030" Cornwall Insight, 23 July 2024. Link here <https://www.cornwall-insight.com/press-and-media/press-release/solar-and-wind-to-account-for-just-44-of-power-generation-by-2030/>

⁴ House of Commons Environmental Audit Committee, Sixth Report of Session 2023-24: Enabling sustainable electrification of the economy. Link here <https://committees.parliament.uk/publications/45077/documents/223429/default/>

She also said that government-commissioned advice from NESO will feed into the Government's "clean power 2030 action plan." So we can expect further announcements on this front.

Supply Chain Problems

The UK is not alone in wishing to expand its renewables sector. Across the world there is an increasing demand for the necessary materials and this is placing constraints on the supply chain. It is particularly significant in the offshore wind industry and, in a different way, in solar. A report for government by Baringa earlier this year identified eight key components required for offshore wind facilities where there is a "high or medium-high" risk of capacity constraints (and none as having a low or medium-low risk)⁵. At the same time, the International Energy Agency has identified the increasing concentration of solar manufacturing in China (now 80% of world production) and its control of rare earth materials required, as posing a risk to the sector⁶.

Financing the Investment

Even if, with a fair wind, these concerns can be overcome, financing the necessary investment will be a serious challenge. The annual CfD auction process will continue but additional levers will need to be pulled to get anywhere near the level of generation capacity required. Government and Great British Energy will play an important part in this but won't, on their own, provide the necessary financial muscle. Great British Energy's £8.3 billion to be deployed over the life of the parliament is a far cry from the £28 billion a year that Labour had originally floated. Cornwall Insight believes that £48 billion, on top of the £18 billion cost of scheduled projects, would be necessary to hit the Government's 2030 goals for renewables⁷.

The projects required will be numerous and involve a very wide range of capital investment, from 25 hectare solar arrays through to giant offshore windfarms. Infrastructure projects attract different investors at the successive stages of their development. In the earlier stages developers, skilled equity investors and project financiers may be involved. As the sector becomes established and individual projects are derisked institutional investors, who seek a more certain, if lower, return may be interested. All the evidence is that, with a stable regulatory regime and the underwriting provided by CfDs, UK infrastructure is an attractive investment.

Opportunities for HNWs

⁵ Baringa Partners LLP: UK renewables deployment supply chain readiness study, April 2024. Link here <https://assets.publishing.service.gov.uk/media/6617b12ed88c988e81b95af8/uk-renewables-deployment-supply-chain-readiness-study-executive-summary.pdf>

⁶ International Energy Association: World Energy Outlook 2024, October 2024. Link here <https://www.iea.org/reports/world-energy-outlook-2024>

⁷ "Solar and wind to account for just 44% of power generation by 2030" Cornwall Insight, 23 July 2024. Link here <https://www.cornwall-insight.com/press-and-media/press-release/solar-and-wind-to-account-for-just-44-of-power-generation-by-2030/>

The projects that come through will attract different financiers by reference to their size and risk. We think that there is an untapped source of finance for smaller to medium sized projects. Investments in debentures issued by a company can be held in an Innovative Finance ISA (IFISA) if the investor's subscription is arranged online through an electronic system by an FCA authorised person. Roger Blears explained in our September edition of *Viewpoints*⁸ how this could provide High Net Worth investors with a tax-free return via the coupon on debentures held in an IFISA account. Companies could issue those debentures at an interest rate which would prove attractive given the tax free nature of the interest payment. Such debentures are unlikely to be of interest to investors in higher risk situations but solar farms and onshore wind farms once fully consented, and more so once operational, could well be a suitable vehicle for the issue of IFISA debentures.

There are sure to be delays and obstacles in the way of the ramping up of renewable energy generation. But it is clear that the Government is committed to bringing forward a step change in the rate of development in the sector and that will provide exciting and profitable opportunities for industry and for investors.

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1 November 2024

⁸ September Edition Viewpoints Link here <https://blears.com/blog/2024/09/04/lower-cost-debenture-capital-for-smes-social-housing-and-energy-infrastructure-raising-capital-outside-the-speculative-illiquid-securities-fca-restrictions/>