



# Insights: CfD investor analysis

November, 2020

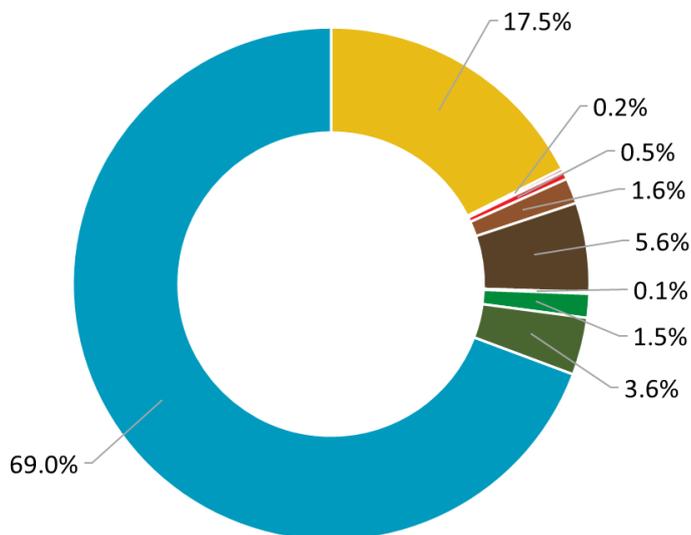
**James Rushton** Director of Scheme Delivery

When I started in the then Department of Energy and Climate Change back in 2012, Electricity Market Reform (“EMR”), and in particular the CfD, was a “blank sheet of paper”. I was personally involved in developing EMR, leading the negotiation of the only bespoke CfD for Hinkley Point C, and bringing my experience from my investment banking background.

As somebody who always finishes what they start, I moved over to LCCC to manage the contracts. It has been interesting implementing and applying what we created to actual projects and learning from that experience.

## 1. The CfD portfolio today

We have [previously shown](#) how CfD projects are delivering. If the trends identified continue, the 19 GW of CfD capacity contracted will represent over 15% of total GB installed capacity by 2025. I would like to take a closer look at the two key aims of the CfD which underpin this investment: 1) to reduce the cost of capital; and 2) to increase the pool of investors in low carbon generation.



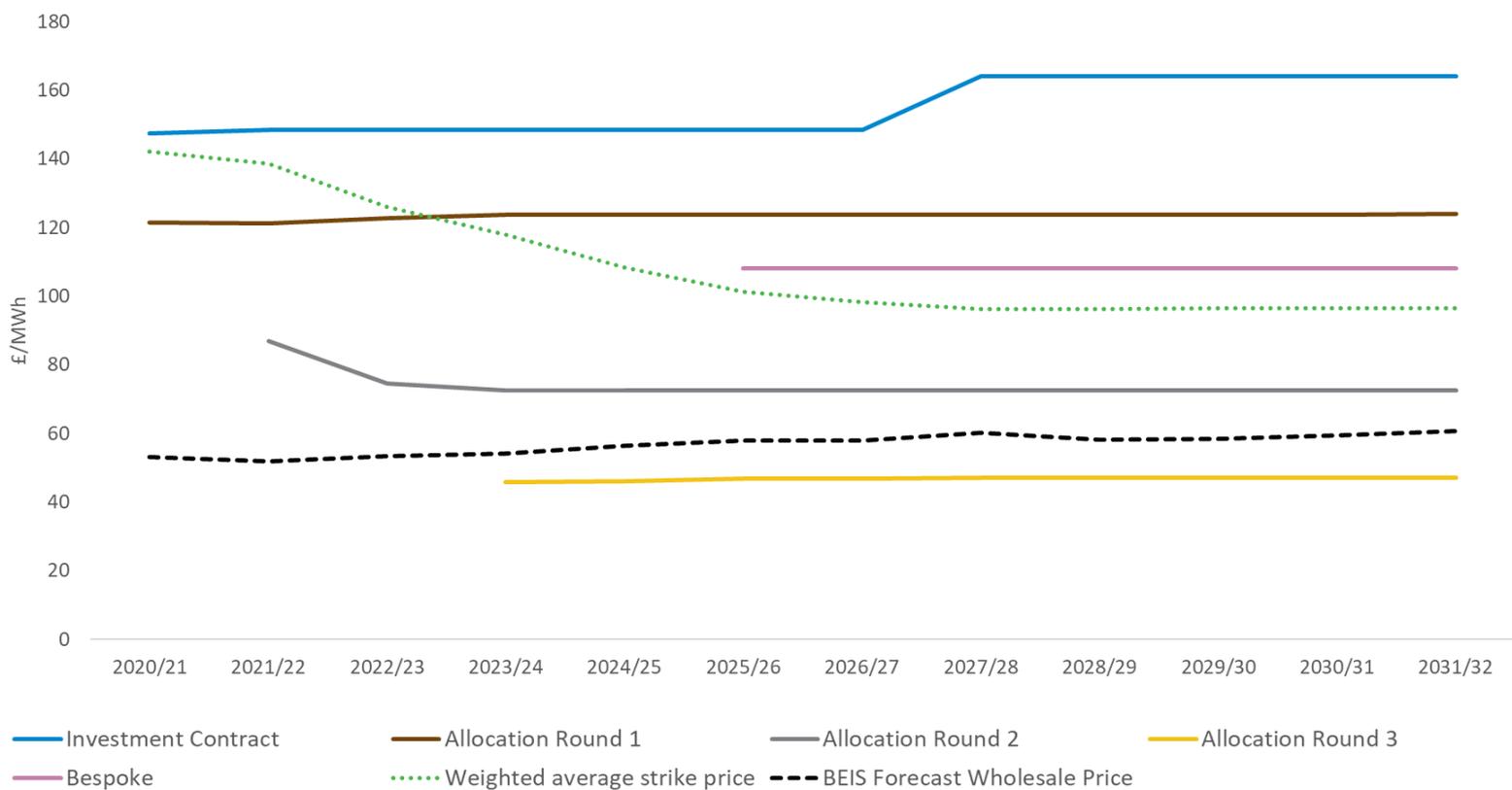
- Nuclear
- Advanced Combustion Technologies
- Biomass Conversion
- Remote Island Wind
- Offshore Wind
- Energy from Waste with CHP
- Dedicated Biomass with CHP
- Solar
- Onshore Wind

## 2. Driving down costs of CfDs

Strike Prices have fallen significantly with each successive auction round, particularly in offshore wind, as shown in the diagram overleaf.

While it is clear that, as expected, technology costs have fallen as technologies mature, another key driver of cost reduction is the cost of capital, both debt and equity. While in this paper we

*Technology shares of CfD portfolio by MW (%)*



*Weighted average strike prices by CfD allocation process (2019 real prices)*

cannot quantify the precise impact of each, both have contributed significantly to the reduction in CfD costs.

Our [recent study](#) with Grant Thornton looked at the debt and equity funding of CfD projects. The CfD is clearly “bankable” and we have seen many projects raising debt up to 80% of project value secured against the CfD revenues. The cost of energy from CfD projects has also been brought down by the low level of interest rates since the financial crisis of 2008-09.

As the CfD and low carbon generation market mature, investors become more comfortable with the framework and associated risk profile of CfD projects, which in addition reduces the required equity returns. A key indicator of this is the type of investors in projects.

Our study found that the CfD has led to the hoped-for diversification of investors, who are also getting involved earlier in the project lifecycle as shown in the diagram overleaf. This

not only increases the *volume* of capital available but also reduces the *cost* of capital.

Even at today’s prices, every 1% reduction in the cost of capital (WACC) represents circa.£3/MWh off the Levelised Cost Of Energy for offshore wind with a knock-on effect on Strike Price<sup>1</sup>.

### 3. Can the CfD’s success be replicated?

It is clear to me that the CfD has delivered against both aims of bringing down the cost of capital and increasing the pool of investors. It is also fair to say it has done this faster than expected.

Looking back, it was a significant achievement to get EMR done and in a relatively short period of time!

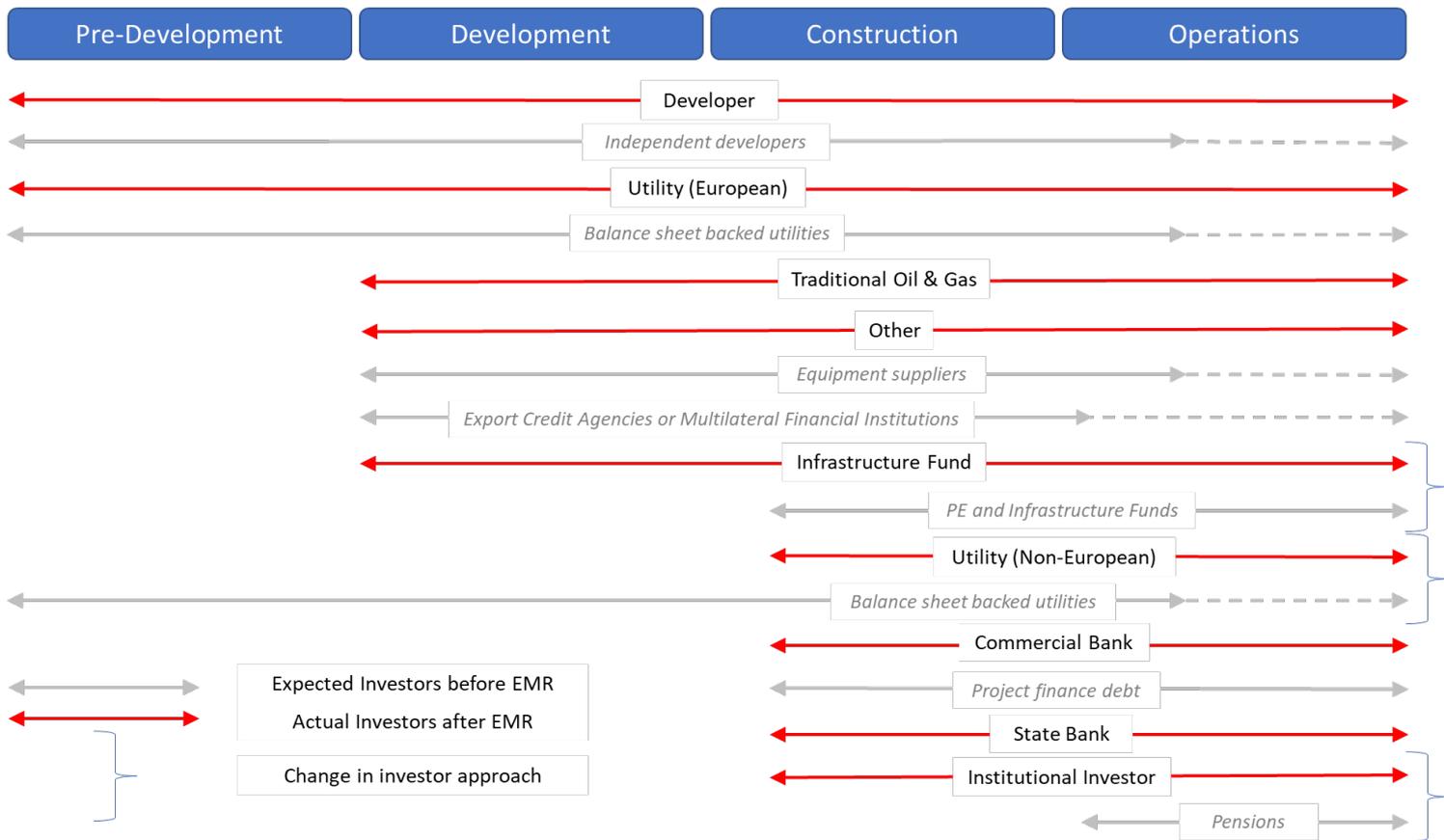
However now is not the time to stand still, to achieve Net Zero much more needs to be done. CfD costs cannot continue to fall for ever, new

<sup>1</sup> Analysis using [LCCC WACC tool](#).

technologies need to be brought on line and other sectors also need to be decarbonised.

Can the success of the CfD be replicated across

these additional technologies and sectors? It's going to be an interesting time and watch this space... Is everyone ready for EMR round 2?



Types of investors and timeline of their involvement in projects