

The power sector investment drought has broken

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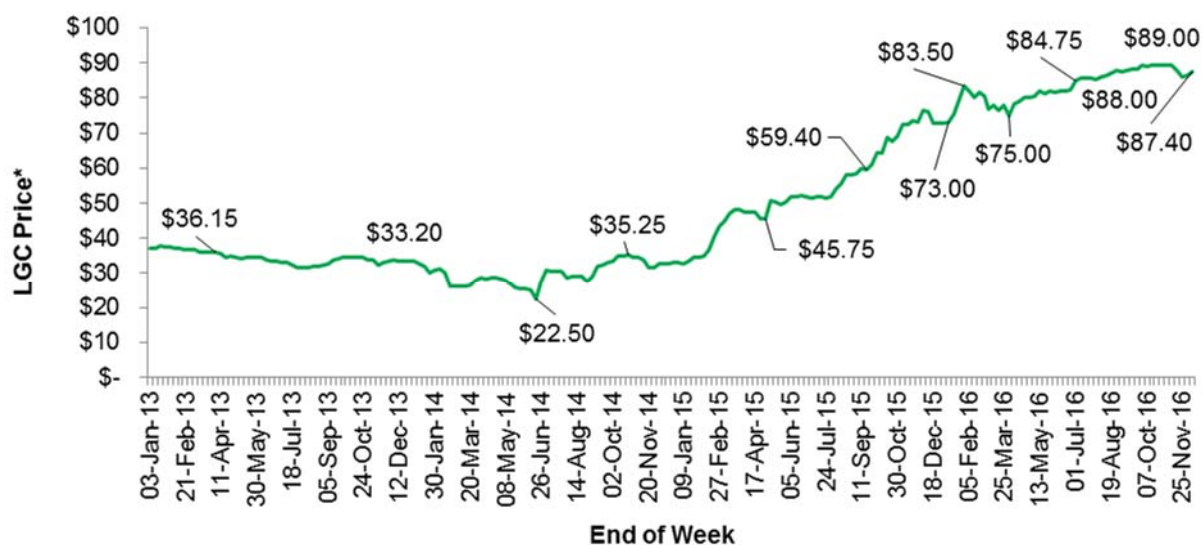
The Chief Scientist Alan Finkel hit the nail on the head that the electricity sector is stuck in a regulatory limbo land that has undermined investment confidence. It is almost like investors have found themselves caught in some nightclub towards the end of the night where they are left with a choice between just two overzealous suitors - Cory Bernardi or Bob Brown. Meanwhile both Cory and Bob are threatening to violently hurt the investor if they choose the other suitor. In such a situation the easiest thing to do is to exit the dancefloor altogether.

However what the Finkel committee may not have realised is that the situation is just about to make a turn for the better after a very dark period. It turns out Bob Brown is getting more attractive as the night goes on. Meanwhile Cory Bernardi is showing a distinct lack of stamina and starting to look a bit puffed.

Yet it has been a dark period. At the beginning of this year [Green Energy Markets](#) estimated that in order for supply to meet demand under the Renewable Energy Target we'd need to commit around 4400MW of new capacity to construction (assuming it were all wind at a 38% capacity factor). At the end of September we'd only committed 529 megawatts. What's more 234 megawatts didn't actually count towards the national Renewable Energy Target as it would be surrendered by the ACT Government to meet its own target.

The end result is the market is now pricing in an almost certain shortage of LGCs, with spot market prices having now climbed to a level just a few dollars short of the tax-effective shortfall penalty.

LGC spot prices since 2013



Source: Green Energy Markets

Green Energy Markets Insight

Green Energy Markets keeps track of the LGC liabilities and holdings of each individual power retailer and large industrial customer in Australia, as well as their likely future receipts of LGCs from projects they own or have contracted with. Based on this data within our [LGC Holdings Report](#) it looks as though several of the smaller power retailers, as well as a large second tier retailer and some of the large industrial customers may not have sufficient LGCs to meet compliance this coming February. For some of them we suspect it is a conscious decision that given they aren't in a tax paying position they are financially better off paying the \$65 non-tax deductible penalty instead of buying LGCs at about \$85-to \$89.

Yet while the level of renewable energy project commitments over the nine months to September were insipid at just 529MW, signs are now emerging that investors have begun to re-emerge from their Tony Abbott bunkers. In the 3 months since September 581MW were committed to construction. We know of several hundred more megawatts that will be committed shortly based on intelligence we have gathered from a range of industry participants. This includes the remaining ARENA-funded large scale solar projects, but also several new wind farms and even solar farms that don't have ARENA support.

Pleasingly the larger power retailers are stepping back into the market offering long-term power purchase agreements (PPAs) or investing directly in projects. EnergyAustralia recently contracted with the Manildra Solar Farm and has stated it is seeking 500MW of contracted renewable energy projects. Origin Energy should soon conclude the sale of Stockyard Hill with its accompanying PPA for as much as 500MW. In addition we understand they are advancing plans to potentially expand the Darling Downs solar farm well beyond the current 110MW funded by ARENA. AGL has also indicated it is likely to press ahead with the 200MW Silverton and 300MW Coopers Gap wind farms next year. Synergy's PPA with the Emu Downs Solar Farm is an indicator they should be close to concluding their own procurement process for 500,000 LGCs per annum. And with Alinta now going to an IPO it also appears set to enter the market, as shown by its purchase of the Yandin Hill wind farm development site.

There is even some tentative signs of financiers willing to take merchant risk. The recent commitment of Sapphire Wind farm with 170MW of uncontracted capacity is one sign of this. Goldwind also appears prepared to add more merchant exposed projects beyond the 175MW uncontracted White Rock Wind Farm. And the new owners of Pacific Hydro are also showing signs they may follow in the footsteps of Goldwind.

When coupled with State Government initiatives to provide contracts that provide long-term revenue security, it's likely we'll finally see gigawatts of projects rolled out in the next few years.

While this might be the kiss of death to Ministers Greg Hunt and Josh Frydenberg's career prospects, both have played a valuable role in restoring the battered confidence of renewable energy investors. Hunt followed by Frydenberg have made unambiguous, public statements that the current RET is secure. This was affirmed most recently by Minister Frydenberg in his release of the 2017 Climate Change Review terms of reference where he stated, "The Government is ... committed to a Renewable Energy Target of 23.5 per cent by 2020 which was legislated in the Federal Parliament in 2015."

Of vital importance to investor confidence, the government left the RET out of the scope of the terms of reference for the Climate Change Policy Review.

What is also aiding investor confidence is that the difference between the underlying cost of a new renewable energy project and the wholesale electricity contract price have narrowed considerably. Wholesale baseload power contracts for 2019 are trading at a bit above \$65 per megawatt-hour in Victoria, NSW and QLD. Meanwhile a high quality wind project backed by a long-term PPA could be viable at \$75 to \$80 per MWh. That means the value of the LGC (while still very important) is becoming less important to the overall viability of the project. What's more the plunging cost of ground-mount solar projects has opened up a vast new source of LGC supply that is not far off wind's costs.

Green Energy Markets Insight

Given last quarter's poor economic growth figures, this construction activity should represent a shot in the arm to regions such as Northern Queensland that are suffering from the bust in mining investment. Unfortunately there are signs this government may be contemplating a scare campaign around Labor's 50% renewable energy. If they're not careful this will scare investors away again and in doing so undermine a key source of jobs and growth in regional Australia.

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