

Results that will blow you away

CfD allocation round two

11 September 2017

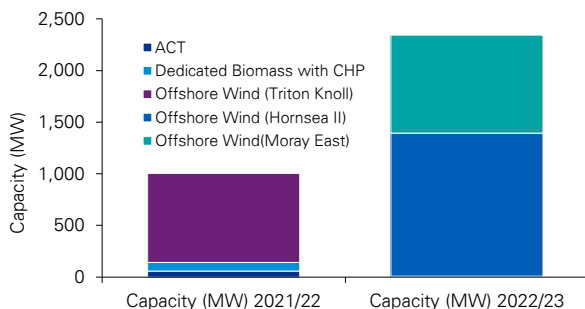
Key points

- The Contract for Difference (CfD) Round two auction delivered a dramatic reduction in costs for offshore wind
- Three offshore wind projects were awarded contracts, with two projects clearing at £57.50/MWh (2012 real)
- In total, the Government announced that 11 projects had successfully been awarded a CfD totalling 3.346GW of renewable capacity
- 149.95MW of 'fueled technologies' were awarded, suggesting the 'maxima' of 150MW was triggered
- Despite the high volume of capacity procured, just £176 million, or 60% of the allocated budget was utilized
- These results will have a significant impact for UK energy policy and the energy mix going forward

A turn up for the books...

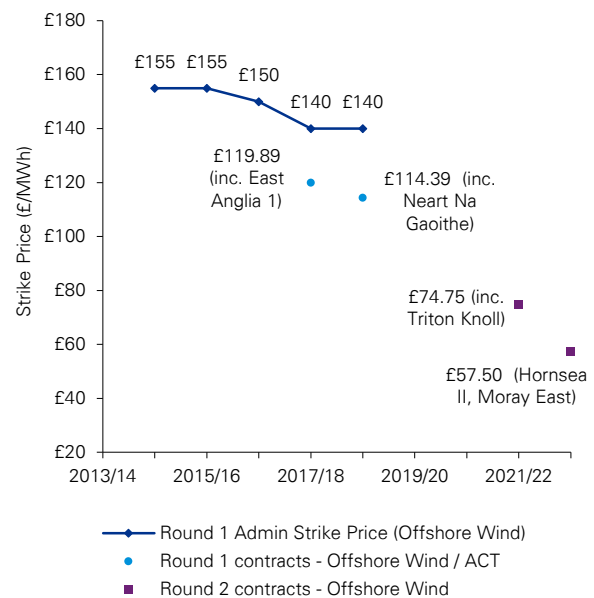
Today the Department of Business, Energy and Industrial Strategy (BEIS) announced the results of the second Contract for Difference (CfD) Allocation Round, for pot two ('less established') technologies. In total, 11 projects have been awarded a CfD with a combined capacity of 3.346GW, which comprises three offshore wind projects, two dedicated biomass Combined Heat and Power (CHP) and six Advanced Conversion Technologies (ACT) projects.

Capacity per delivery year



More exciting even than the total quantum of capacity allocated are the remarkable clearing prices of the 2022/23 Delivery Year. Two offshore wind projects (DONG's Hornsea II and EDPR and Engie's Moray East) both cleared at £57.50/MWh. In 2015, the lowest price awarded for an offshore wind project was £114.39/MWh; just over two years later, we have seen strike prices fall by 50%, although the projects involved were originally four years apart in terms of delivery years. These dramatic cost reductions should secure the future of offshore wind in the UK energy mix, and increase the pressure on other technologies to reduce costs in order to compete.

UK offshore wind cost reduction



A detailed look...

The budget: In November 2016, BEIS announced the details of the second CfD Allocation Round, which included £295m (2012 real) of budget to be made available for Delivery Years 2021/22 and 2022/23 for 'less established' technologies. This comprised of offshore wind, dedicated biomass with CHP, ACT (with or without CHP), anaerobic digestion (with or without CHP), wave, tidal stream and geothermal. Today's announcement sees just £176 million of budget utilised, around 60% of the allocated budget.

This indicates that the auction may have been closed early by a large (possibly offshore wind) project which breached the overall budget closing each respective delivery year.

The projects: 11 projects were allocated CfDs with eight of these allocated in 2021/22. This includes one offshore wind project, two dedicated biomass CHP and five ACT projects. All of these projects cleared at the same clearing price of £74.75/MWh; this suggests that fueled technologies set the clearing price, as the new auction rules implemented for the second Allocation Round prohibit the uplifting of fueled technologies by offshore wind in an attempt to prevent speculative bidding.

In the 2022/23 Delivery Year, a single ACT project was awarded a £40/MWh contract, below the average wholesale price over the past year,^(a) and below BEIS' wholesale price projections of £45.61/MWh between 2021/22 and 2024/25.^(b) As such, if a CfD is signed and the forecast wholesale prices hold true, the developer could be obliged to pay back to the Low Carbon Contracts Company (LCCC). Given this, one could speculate that the bidder may have been seeking an uplift and may not ultimately sign the contract.

Two further offshore wind projects cleared in the 2022/23 Delivery Year at £57.50/MWh, a record low for offshore wind in the UK and consistent with the cost reduction trends seen in recent European auctions, adjusted for scheme differences.

Maxima: A total of 149.95MW of 'fueled technologies' were awarded a CfD. This would suggest that the maxima of 150MW of 'fueled technologies' (dedicated biomass with CHP, ACT and anaerobic digestion) was triggered. This would mean that additional fueled technology projects may have been affordable as part of the overall budget but were unable to come forward due to maxima.

The pathway forward...

This auction result provides a significant boost for the renewables sector as the Government seeks to finalise its Clean Growth Plan. The Government has delivered greater capacity at a lower cost than was predicted by itself or by most experts. This should cement the role of offshore wind in the UK energy mix.

The result will change the cost competitiveness of different generating technologies relative to each other. It will also raise questions about future auction design, in particular, whether the different 'pots' should be merged, given the growing maturity of offshore wind and other 'less established' technologies.

Government previously announced that £730 million would be made available for up to three allocation rounds; in addition to the residual £435 million, £119 million could be released back from this Allocation Round, earmarking £554 million for future allocation rounds. The forthcoming budget should provide an opportunity for the Government to clarify its intentions on future CfD rounds and the availability of budget under the Levy Control Framework.

Today's results bring the UK one step closer to renewable technologies competing against each other on a technology-neutral and subsidy-free basis.

| Project name | Capacity | Technology | Delivery Year | Strike Price (£/MWh, 2012 real) |
|------------------------------------|----------|----------------------------|---------------|---------------------------------|
| Drakelow Renewable Energy Centre | 15.00 | ACT | 2021/22 | 74.75 |
| Station Yard CFD 1 | 0.05 | ACT | 2021/22 | 74.75 |
| Northacre Renewable Energy Centre | 25.50 | ACT | 2021/22 | 74.75 |
| IPIF Fort Industrial REC | 10.20 | ACT | 2021/22 | 74.75 |
| Blackbridge TGS 1 Limited | 5.56 | ACT | 2021/22 | 74.75 |
| Redruth EfW | 8.00 | ACT | 2022/23 | 40 |
| Grangemouth Renewable Energy Plant | 85.00 | Dedicated Biomass with CHP | 2021/22 | 74.75 |
| Rebellion | 0.64 | Dedicated Biomass with CHP | 2021/22 | 74.75 |
| Triton Knoll Offshore Wind Farm | 860.00 | Offshore Wind | 2021/22 | 74.75 |
| Hornsea Project 2 | 1,386.00 | Offshore Wind | 2022/23 | 57.5 |
| Moray Offshore Windfarm (East) | 950.00 | Offshore Wind | 2022/23 | 57.5 |

Source: BEIS

Notes: (a) Based on BEIS Updated Energy & Emissions Projections, March 2017 (2012 prices);
 (b) CfD Allocation Framework
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/601120/Allocation_Framework_for_the_second_Allocation_Round.pdf

Delivery Year 2021/22
 Delivery Year 2022/23

Contact us



Simon Virley CB
Partner, Head of Power & Utilities

T: +44 (0)20 7311 5037
 E: simon.virley@kpmg.co.uk



Bridget Beals
Associate Director, Power & Utilities

T: +44 (0)20 7311 4684
 E: bridget.beals@kpmg.co.uk

kpmg.com/uk



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Designed by CREATE | Date | CRT086723A