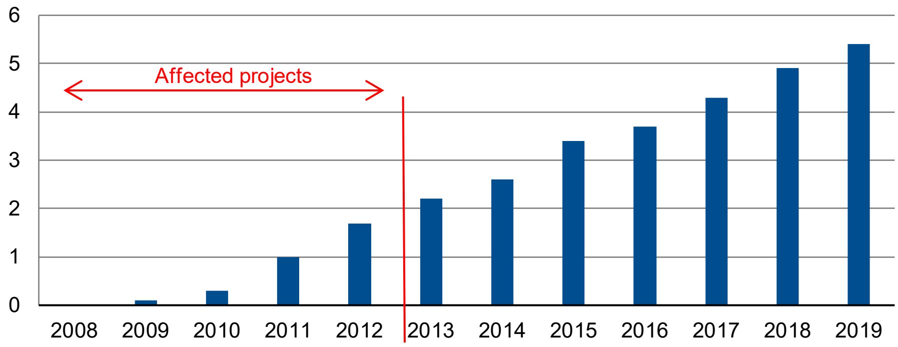
Pre-2010 solar PV subsidy cuts threaten project debt sustainability

The French government's proposal to retroactively cut subsidies for solar photovoltaic projects with preferential 2006–2010 tariffs threatens the ability of those projects to service their debts and could – if enacted – result in the need for widespread debt restructuring.

The proposed budget amendment approved by the National Assembly on 13 November diminishes the credibility of the government's ambitious renewable energy expansion strategy and may erode investors' trust in the government's willingness to honour its long-term commitments. The government's proposals serve as a powerful reminder of the critical importance of economic fundamentals and the important role of Black Swan risk in project finance credit analysis.

The draft bill would, if approved by the senate and signed into law, affect all solar photovoltaic projects supported by the decrees of July 10, 2006, January 12, 2010 and August 31, 2010 and which have a capacity of at least 250 kW. That, in effect, captures 99.5% of all projects that benefit from these decrees. It includes projects developed and connected to the grid roughly until 2012 (see Figure 1).

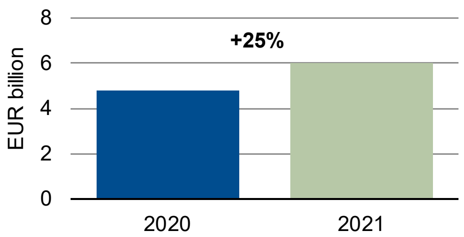
Figure 1: Solar photovoltaic capacity additions in France 2008–2019 (Gigawatts)



Source: IEA

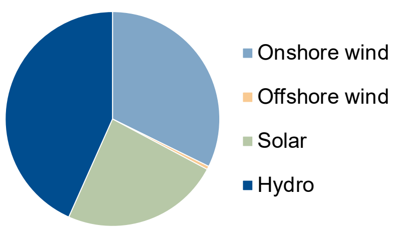
The latest draft amendment follows the government's assessment that the EUR 2bn in annual payments to solar projects that benefit from the decrees are excessive in relation to the energy produced, and are not commensurate with the precipitous declines in capital costs that the solar industry has seen in recent years. Despite the proposed cuts, the budget for renewable energy expenditures is envisaged to increase by 25% for 2021.

Figure 2: France renewables spending 2021



Source: IEA, Scope

Figure 3: France renewables mix 2021E



Source: IEA, Scope

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Related Research

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Detailed measures include a potential backstop

The stated objective of the draft bill is to cut the tariff of the relevant contracts to reduce their profitability to "a level corresponding to a reasonable return on capital". Discussions in the National Assembly involved attempts (ultimately rejected) to incorporate more detailed measures, including the shortening of the contracts' original duration to 13 years from 20 years. While the draft bill does not contain specific measures, it features a "safeguard clause" which aims to prevent a wave of bankruptcies by allowing affected companies to seek a bilateral arrangement with the State if they can demonstrate that the subsidy cuts would otherwise make the project unviable.

Potential credit impact

Proposed retroactive cuts could lead to debt restructurings

While the potential impact is uncertain since the specific measures have yet to be defined, retrospective subsidy cuts would threaten the credit quality of the projects affected. Despite the potential backstop from a "safeguard clause", the proposed measures could heighten the risk of widespread debt restructuring as projects' economic fundamentals become impaired, making it difficult to comply with their debt obligations. Many of the projects affected by retroactive cuts in Spain in 2013/14, for example, were forced to undergo financial restructurings. Most solar photovoltaic projects in France are highly leveraged and financial structures rely on the government's promise to support the project over a long period, typically 20 years.

Furthermore, since many of the affected projects have been sold or traded in the secondary market over the past 10 years, project buyers and new investors are likely to suffer the brunt of potential losses imposed by retroactive changes, as previously expected returns have not yet materialised. Current stakeholders will be incentivised to seek legal redress, potentially resulting in lengthy and costly legal disputes.

Focus on economic fundamentals

Investor trust in the government could become impaired

The proposed budget amendment would set an important precedent that could impair investors' trust in France's ambitious renewable energy development goals and diminish the credibility of the government's long-term promises in support of developing new and risky technologies in the future.'

Against the potential reputational cost, the government expects a modest financial benefit from the retroactive cuts estimated at EUR 400m to EUR 600m per year (around 0.04% of annual public expenditures). In turn, however, future new technology development via public partnerships or co-funding will potentially require higher state contributions to convince private investors to participate in such projects.

The proposed amendment is still under reading by the Senate and could be re-submitted with modifications to the National Assembly. The high and rising importance of the renewable energy sector and increasing public involvement, including pressure from the industry, could still see last-minute changes to the draft law despite the failure of previous negotiations between government and industry.

Black Swan risk drives credit quality in project finance

The proposed retroactive subsidy cuts – if enacted – serve as a stark reminder of the critical importance of economic fundamentals in credit analysis. A sound economic rationale and the viability of a project to survive in market conditions are increasingly important and typically represent the last line of defence protecting investors from significant changes that may affect a project in the long run. Scenario and sensitivity analyses complement the fundamental analytical approach that Scope applies. Our focus on expected-loss ratings explicitly captures Black Swan events – such as the risk of retroactive subsidy cuts – that characterise credit risk in project finance.

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