Solving the Credit Barriers to Scaling Clean Energy Procurement

Takeaways from CEBI's workshop at VERGE 2022

October 26, 2022

Call to Action

Growing market access for clean energy customers is necessary for grid decarbonization, and insufficient credit ratings are blocking a large portion of prospective energy customers. For clean energy procurement mechanisms, such as power purchase agreements (PPAs), project financiers typically seek off-takers with investment-grade credit to guarantee future project revenues and ensure an expected return on their investment. In 2018, less than 30% of PPA off-takers had medium grade credit or lower, while more than three-quarters of credit rated companies had similar ratings[1]. The Clean Energy Buyers Institute (CEBI) is connecting stakeholders to understand existing credit solutions and address gaps to increase market access for all energy customers.

Topline Takeaways

In an October 2022 workshop, CEBI convened experts and interested stakeholders to explore this issue and four existing solutions; insights included:

- Lack of a sufficient credit rating is difficult to overcome for potential energy customers, a fact that is made worse as the clean energy market tightens as some developers are prioritizing prime credit-rated off-takers.
- Credit ratings are a tool to provide trust for financiers. Solutions require building trust without this assurance, leveraging existing relationships, using outside advisors, and finding partners who are willing to work with you.
- Collaboration is key to navigate and build creative solutions. Workarounds do exist, but no solution is without its challenges.
- *Energy customers need to get comfortable with trade-offs*, such as:
    - Being open and upfront about lack of or insufficient credit
    - Sharing financials and being transparent about bankability
    - Considering different, even if unfavorable, contract terms
    - Taking on more risk
    - Paying higher costs for transactions
    - Not being able to secure a deal

The following pages include benefits and challenges of the four solutions that were explored. CEBI is grateful for our expert speakers and workshop participant input. If your company would like to engage around overcoming credit barriers or otherwise learn more about CEBI's related work in the Decarbonizing Industrial Supply Chain Energy (DISC-e) initiative or Small and Medium Business Accelerator (SaMBA), please contact us at communications@cebi.org.

[1] S&P Global: Credit ratings in PPA portfolios; distribution of corporate debt by rating

Potential Solutions

Current solutions to credit barriers tend to be unique to the circumstances of the project, but there are several existing models to consider. These and any other potential solution require being creative, accepting tradeoffs, and building trust.

1 | Leverage existing banking relationships

Utilize an existing bank as a potential lender **or** as backing to increase confidence for the investor. Leveraging known banking history can secure trust between lender and off-taker.	
Benefits ✓ No additional transaction costs (typically) ✓ No significant added risk; "soft risk acceptance" ✓ Could help lower credit posting marginally	Challenges ⊗ Not scalable ⊗ Relies heavily on the relationship with just one entity ⊗ Compounding risk concern for banks

Leveraging an existing relationship with a bank can be helpful but is not scalable nor can it work for every entity. The key to success for this solution is trust and transparency. A willingness to share banking history can help a lender feel more comfortable, leveraging previously established trust to secure financing.

2 | Use a "credit sleeve"

An intermediary party stands between the developer and energy customer and provides an acceptable credit profile to the lender. This intermediary is shouldering risk but earning a 'sleeve fee' which is shared by the energy customer and seller.	
Benefits ✓ More scalable ✓ Easy to understand ✓ Enables energy customer to get access to an off-take from a new project	Challenges ⊗ Expensive with extra fees ⊗ Details can vary depending on energy customer ⊗ Is harder to implement outside organized power markets

A credit sleeve is similar to receiving a letter of credit but with more transaction costs. Though this solution is more accessible, it does have limited optimal use cases. It may be better suited for utility-scale or larger projects. Due to costs and risk bared by the intermediary, it may work best for medium-grade credit and could be too expensive for low-grade or non-credit rated off-takers.

The challenges of costs can be overcome depending on the off-taker's relationship with the intermediary. Sleeve fees can be lowered if the off-taker has previous trust with the intermediary. This shows potential coupling with solution #1 –allow off-takers to leverage existing relationship to use a credit sleeve.

3 | Post high credit amounts

Demonstrate financial resources to provide investors assurance that debt will not default. Liquidity is a guarantee rather than credit profile.	
Benefits ✓ Proactively addresses the credit issue can make energy customers look more attractive to lenders	**Challenges** ⊗ Expensive (increasing under current market) ⊗ Requires large amounts of cash limits liquidity and future borrowing power ⊗ Not scalable or replicable for multiply deals by one company

This solution is straightforward and clearly provides guarantees to lenders in lieu of investment-grade credit. However, it presents other financial risks for the off-taker, including limiting the ability to borrow more debt.

4 | Be flexible on contract terms

Increase attractiveness to developers and financiers by being flexible on PPA commercial terms, including and sharing risk with sellers.	
Benefits ✓ May not require a premium on the amount of credit posted	**Challenges** ⊗ Requires giving more on other commercial terms which also have a financial impact

In the current market, developers are pushing more risks onto off-takers. Demonstrating a willingness to take on more risk and potentially less-desirable contract terms will attract developers who are willing to work with energy customers. Be comfortable with taking on more burden to get deals done.

These solutions are a collection of potential opportunities to increase clean energy transactions for lower-grade and non-investment credit rated off-takers. Additional models put forth by workshop participants included using partners with investment-grade credit as a backstop, employing shadow credit, and burgeoning insurance policies. CEBI is exploring these solutions and new concepts. Please reach out if you would like to engage further.