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ROUND TWO OF EGYPT'S FEED-IN TARIFF...

RESURGENCE?

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ROUND TWO OF EGYPT'S FEED-IN TARIFF... RESURGENCE?

In a step by the government to attempt to revive the renewable energy feed-in tariff (FiT) program, the Minister of Electricity and Renewable Energy announced in a press conference held on 6th of September 2016 the main terms and conditions for the Second Round of the FiT program which will be opened as of 28th of October 2016. Following to the press conference, formal letters were sent to developers by EEHC on 8th of September 2016 outlining the new Round Two tariffs as well as the main terms and conditions thereof.

Round One of the program was launched in October 2014 and despite the economic challenges in Egypt, particularly and current USD crunch and non-availability of foreign currency, the bidding for the large-scale solar projects was highly competitive and exceeded the government's targeted capacity of 2,000 mw by around 50%. However, Round One FiT suffered from extreme hardships that quashed expectations of the government, developers and international financial institutions alike to see a critical mass of projects that can comply with the government's conditions, secure international financing and achieve financial closure before Round One deadline on 27th of October 2016.

The poor outcome of the Round One FiT is particularly due to the decline of the major international financial institutions to participate in funding the Round One projects over disagreement with the government on offshore arbitration provisions in the project agreements. The funding hardship coupled with the government's requirement that at least 85% of funding is secured through offshore financing made it extremely difficult for most of the developers to strike a deal in Round One.

The conditions of Round Two FiT as announced by the Minister of Electricity and Renewable Energy aim to address some of the drawbacks of Round One, particularly offering offshore seat of arbitration. In exchange, the Round Two tariff comes significantly lower than the Round One tariff, which was indicated by the government in a number of instances as highly lucrative compared to other nearby jurisdictions (for example, Jordan and UAE).

Still no formal decree is issued by the Cabinet of Ministers with the terms of Round Two and all information available is based on the press conference held by the Minister of Electricity and Renewable Energy and the letters sent to developers by EEHC.

01

REVISED TARIFF

To put the second round into perspective, the Round Two tariffs for solar projects witnessed around 41% reduction compared to Round One tariffs.

Similar to Round One, the tariff of large scale projects is denominated in USD, but payable in EGP equivalent comprising: (i) a floating 70% portion calculated on EGP/USD market rate; and (ii) a fixed 30% portion calculated on a fixed rate of EGP 8.88 per USD. Accordingly, the fixed rate component of the USD/EGP formula used to calculate the tariff payments was doubled from 15% to 30% of the invoiced amount, doubling the developers' foreign exchange exposure. It must be noted that the fixed rate is now higher to cater for the last devaluation of the Egyptian Pound at the official rate of EGP 8.88 per USD (instead of the former fixed rate of EGP 7.15 per USD), hence it almost breaks-even with overall reduction in the electricity price still around the 40-41%. However, with further devaluation of the EGP expected imminently, this increase in the fixed rate portion of the tariff may result in practically a higher reduction in the overall paid electricity price depending on the size of devaluation of the EGP during the coming period.

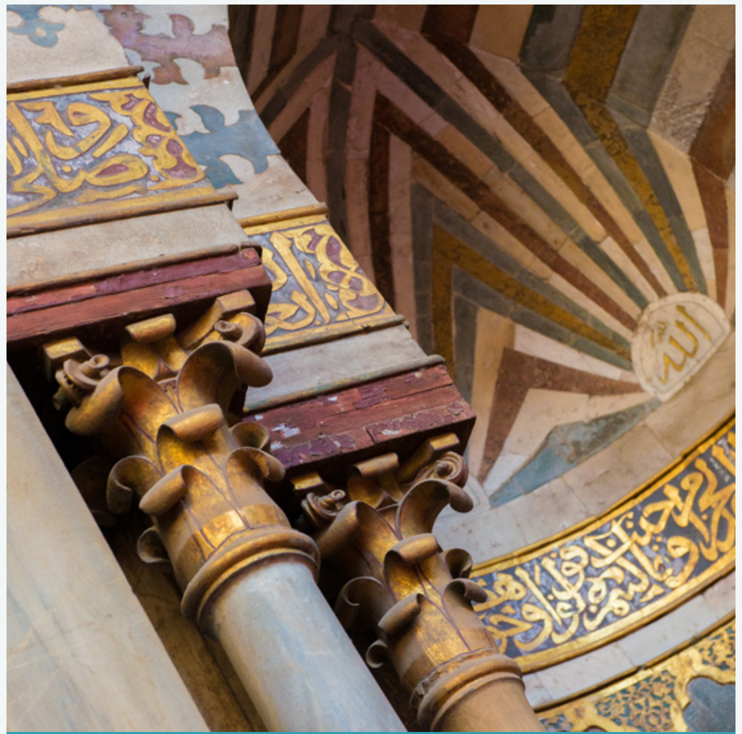
INSTALLED CAPACITY	ROUND ONE TARIFF PER KW	ROUND TWO TARIFF PER KW
Residential	84.7 EG piasters	102.88 EG piasters
Non-residential Less than 200 kw	90.1 EG piasters	108.58 EG piasters
200 kw – 500 kw	97.3 EG piasters	108.58 EG piasters
500 kw – 20 mw	13.6 US cents	7.88 US cents
20 mw – 50 mw	14.34 US cents	8.4 US cents

As for the wind projects, the tariff is more complex as it is tied to the number of operating hours of the station. The main amendments were to introduce a flat tariff for the whole project lifetime instead of the former two-stage tariff adopted in Round One. In addition, additional tariffs were introduced for higher operating hours in Round Two, which was not catered for in the Round One tariff. The government also raised the fixed rate component of the USD/EGP formula used to calculate the tariff payments from 30% to 40%, thus increasing the developers' foreign exchange exposure to future EGP devaluations.

HOURS OF OPERATION	ROUND ONE TARIFF PER KW		ROUND TWO TARIFF PER KW
	FIRST FIVE YEARS	REMAINING 15 YEARS	
2,500	11.48	11.48 US cents	7.96 US cents
2,600		10.56 US cents	7.65 US cents
2,700		9.71 US cents	7.37 US cents
2,800		8.93 US cents	7.11 US cents
2,900		8.19 US cents	6.86 US cents
3,000		7.51 US cents	6.63 US cents
3,100	9.57	8.93 US cents	6.42 US cents
3,200		8.33 US cents	6.22 US cents
3,300		7.76 US cents	6.03 US cents
3,400		7.23 US cents	5.85 US cents
3,500		6.73 US cents	5.69 US cents
3,600		6.26 US cents	5.53 US cents
3,700		5.81 US cents	5.38 US cents
3,800		5.39 US cents	5.24 US cents
3,900		4.98 US cents	5.10 US cents
4,000		4.6 US cents	4.97 US cents

HOURS OF OPERATION	ROUND ONE TARIFF PER KW		ROUND TWO TARIFF PER KW
	FIRST FIVE YEARS	REMAINING 15 YEARS	
4,100	N/A	4.85 US cents	4.85 US cents
4,200	N/A	4.74 US cents	4.74 US cents
4,300	N/A	4.63 US cents	4.63 US cents
4,400	N/A	4.52 US cents	4.52 US cents
4,500	N/A	4.42 US cents	4.42 US cents
4,600	N/A	4.33 US cents	4.33 US cents
4,700	N/A	4.23 US cents	4.23 US cents
4,800	N/A	4.15 US cents	4.15 US cents
4,900	N/A	4.06 US cents	4.06 US cents
5,000 or More	N/A	4.00 US cents	4.00 US cents

The government justified such reduction in the Round Two tariffs by the declines in investment costs and levelized energy costs for renewable energy as well as the tax and customs reductions that were introduced in 2015 after the launch of Round One FiT. Though it is worth noting that there are no special tax or customs incentives applicable to FiT projects, where the normal corporate tax rate of 22.5% (instead of the former 25%) and customs rate of 2% for production items (instead of the former 5%) apply as per the recent amendments to the general income tax law and the investment law.



02

ROUND TWO ELIGIBILITY & DEADLINE

Given the expectations that minimal or no capacities at all will be implemented in Round One, no additional targeted capacities were introduced to the Round Two FiT. The targeted capacities for both solar and wind FiT remain the same at 2,000 for each made on a combined basis for both Round One and Round Two (i.e. capacities contracted under Round One will be deducted from the targeted capacities of Round Two).

Eligibility for Round Two participation is restricted to qualified developers and consortia in Round One with a possibility to open a new qualification round if the targeted capacities are unachievable by the First Round qualified developers.

Developers who sign project agreement under Round Two solar PV projects must achieve financial closure before 28th of October 2017, that is one year from the Round Two commencement, or reaching the maximum targeted capacities of 2,000 mw from combined Round One and Round Two projects, whichever is earlier. Participant developers must also submit an undertaking for the relevant financiers to that effect within six months (i.e. before 28th of April 2018).

As for the Round Two Fit wind projects, tariff would apply to projects that achieve financial closure within 18 months as of 28th of October 2016 or reaching the maximum targeted capacities of 2,000 mw from combined Round One and Round Two projects, whichever is earlier. Participant developers must also submit an undertaking for the relevant financiers to that effect within one year (i.e. before 28th of October 2017).

It is not clear what is the required content in the financiers undertaking requested by the governments. However, we expect that such undertaking will only declare that financiers and the developer would seek to achieve financial closure before the Round Two deadline on a best endeavours basis, but with no binding undertaking or commitment could reasonably be given by the financiers in that respect.

As for the deadlines for Round Two, it is worth noting that renewable energy incentivization law no. 203 for 2014 mandates the government to commit to the tariff announced by the Cabinet of Ministers for at least two years or the date of achieving the maximum targeted capacities as set out in the tariff determination Cabinet of Ministers' decree, whichever comes first. This mandate is not specific to a particular regulatory round, but rather generic, which may entail that such tariff commitment period applies to any revised tariff as well from the date of its application. Accordingly, there can be an argument that the one-year and the 18-month Round Two deadlines for the solar and wind projects respectively are not entirely in line with the government's mandate as per the renewable energy incentivization law and that the deadline should be two years as of 28th of October 2016.

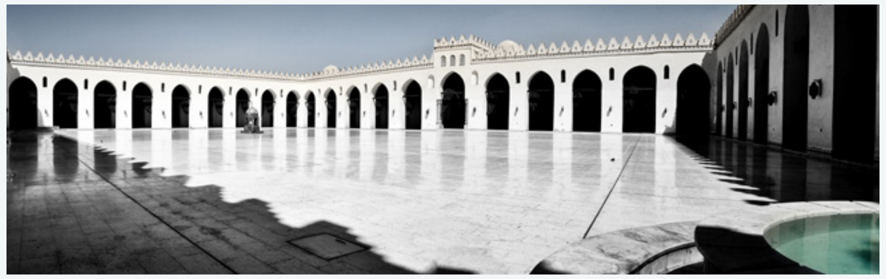
03

ARBITRATION

Despite the heavy negotiations on the project agreements of the Round One FiT, the government's final position was to reject all proposals for having dispute resolution via offshore arbitration (though a proposal for an option to take the arbitration offshore was acceptable in earlier stages of negotiations). The onshore arbitration clause in the project agreements was particularly a deal-breaker issue for the major financing International Financial Institutions resulting in collective pull-out from financing the Round One FiT projects.

In principle, international financial institutions would conceptually expect a neutral venue apart from local courts for resolving disputes in projects involving the government. Having locally seated arbitration at the Cairo Regional Centre for International Commercial Arbitration **(CRCICA)**, as proposed by the government, entails that deciding upon the substance of disputes would stay out of the local court's jurisdiction. Nevertheless, local courts would still have some degree of intervention to review annulment claims of the arbitral award as long as the arbitration is locally seated, which is something the international lenders are seeking to avoid in government projects.

Under the Second Round, the government offers dispute resolution via arbitration seated offshore. Indications suggest that the offshore seat will be either Geneva or Paris. It is not clear, however, whether submission to offshore seat of arbitration will be a default or will be granted as an option to both parties (i.e. the seat of arbitration will initially be Cairo with an option to either party to move the seat of arbitration offshore). In any case, there project agreements will distinguish between the legal seat of arbitration (i.e. the place where the award will be deemed to be issued) which will be an offshore destination, and the venue of arbitration (i.e. the place where physical procedures and hearing will be conducted) which will be Cairo.



04 LOCAL TO FOREIGN FUNDING

With the government insistence on the local arbitration, which was not accepted by all the major International Financial Institutions, only a few developers were able to progress in Round One planning to source majority of project funding in EGP from local banks. However, the Minister of Electricity met with the qualified FiT developers in last August and announced a new condition for closing projects under Round One requiring at least 85% of the project funding, whether in the form of equity or debt, be procured in foreign currency, and only up to 15% procured in EGP. In light of the regulatory ban on Egyptian banks to lend in a foreign currency unless the borrower's cash flows are in the same currency, this requirement means that developers will not be able to source more than 15% of funding from the local banks.

This new requirement had negative impact on the small group of investors who were progressing with Round One, not only because of the timing which is less than three months before the Round One deadline, but also because it quashed any opportunity for investors who were relying on local financing as alternative for the withdrawal of the international financial institutions. However looking at the big picture, developers would typically seek to source foreign currency from the market to convert the EGP funding received from local banks to pay foreign currency capital costs or would seek to shift that burden to EPC contractors for a premium, who would in turn seek to source foreign currency from the open market. Accordingly, by imposing such restriction, the government sought to avoid putting further strain on the foreign currency market, which is already suffering from a severe crunch.

On the other hand, Round Two witnesses more lenient foreign currency funding requirements with 70% minimum for solar projects and 60% for wind projects, sourced either in the form of equity or debt. Such minimum requirements can be of little significance for Round Two projects, provided that the international financial institutions regard the project agreements as bankable and participate in financing Round Two projects.

05 WHY NOT A REVISED ROUND ONE

Finally, with the rather low prospects of projects reaching financial closure in Round One owing to the hardship of securing international financing and the tight deadline of 27th of October 2016, a question may arise as to the reason Round Two is introduced instead of amending the conditions of Round One including a reasonable extension to the deadline.

We believe that there are two main reasons for introducing the new FiT package in the context of Round Two:

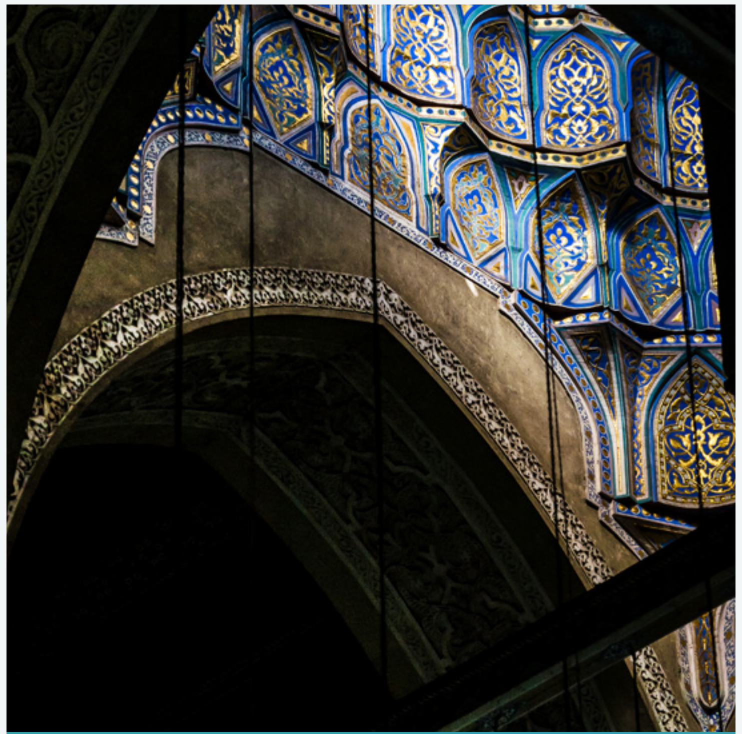
FIRST

some investors, though might be less than a handful, may be capable of striking the deal and win a project in Round One and get the lucrative Round One tariff despite the challenging conditions and deadline; hence, amending Round One conditions would be extremely prejudicial to those limited number of investors.

SECOND

This is because the renewable energy incentivization law mandates the government to commit to the tariff announced by the Cabinet of Ministers for at least two years or the date of achieving the maximum targeted capacities as set out in the tariff determination Cabinet of Ministers' decree, whichever comes first. Accordingly, the government cannot apply any revision to the Round One tariff before 27th of October 2016 or before achieving the maximum targeted capacities (being 2,000 mw for solar energy and 2,000 mw for wind energy).

Indications suggest that the Round Two tariffs may be viewed by developers as much less lucrative than the Round Tariff. Although a vigorous race for the targeted capacities might not be expected in Round Two as was the case for Round One, there may be a good chance in seeing substantial number of projects achieving financial closure in Round Two, provided that the project documents are found bankable by the international financial institutions. Price of lending, cost of capital and margins in light of the new Round Two terms will also be a key factor in determining whether developers will seek to close multiple projects as was the case for Round One.



06 OPTIONS FOR DEVELOPERS

THE LETTERS SENT BY EEHC TO QUALIFIED DEVELOPERS AND CONSORTIA REQUIRES RESPONSE BY NO LATER THAN 7th OF OCTOBER 2016 CHOOSING ONE OF THE FOLLOWING OPTIONS:

FIRST

Proceed and sign project agreements under Round One terms and conditions, which entails:

- Highly lucrative tariff;
- Onshore arbitration, hence non availability of funding from international financial institutions;
- Minimum foreign currency funding of 85% for solar projects and 70% for wind projects; and
- Financial closure deadline by 28th of October 2016.

SECOND

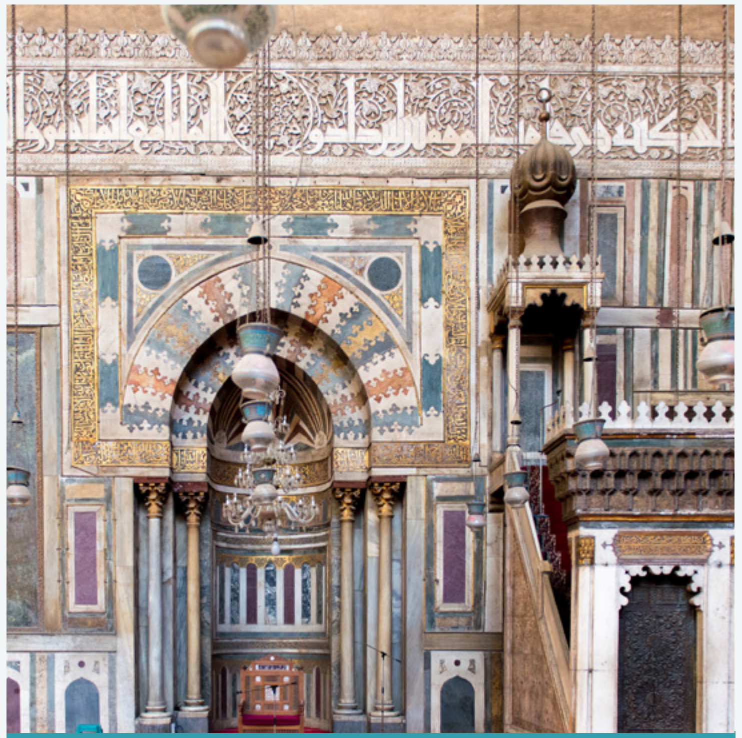
Move to Round Two pursuant to the revised tariff and terms, which entails:

- Reduced tariff;
- Offshore arbitration allowed in the project agreements;
- Minimum foreign currency funding of 70% for solar projects and 60% for wind projects; and
- Financial closure deadline by 28th of October 2017 for solar projects and by 28th of April 2018 for wind projects.

THIRD

Withdraw from the FiT program by submitting request to the government within one month as of 8th of September 2016, which entails:

- Ability to retrieve payments made under the cost sharing agreement without applying any termination penalties. However pursuant to the cost sharing agreement, EETC and NREA will have a period of 6 months from date of termination to refund those payments to the relevant developer; and
- Ability to retrieve the security deposit submitted to NREA for availing project land. It is not clear, however, whether NREA will apply any penalties or deductions to the security deposit upon withdrawal as the land availing MOU provides that NREA will be entitled to retrieve actual costs for availing the land as well as studies made during the land access period.



07 FIT FRAMEWORK AND OPPORTUNITY COST

The challenges that face the Egyptian FiT program are the same that faced similar programs in other countries especially in developing economies that are in transition, particularly debates about the tariff and that government may source cheaper capacities from direct bidding process and IPPs. However, in assessing the virtue of the feed-in tariff, policy makers should take a step back and see beyond the mere comparison of figures.

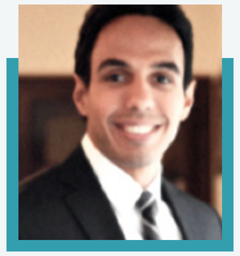
The feed-in tariff is a policy mechanism designed to accelerate investment in renewable energy technologies. In essence, feed-in tariff programs must provide attractive prices aiming at achieving grid parity, where the cost of the renewable technology for electricity production eventually matches the existing average for the relevant area. Accordingly, while first round is lucrative on tariff, there is a long-term gain in eventually creating success story and market for investment leading to eventually unbundling generation capacities between various competing developers and driving prices dramatically low in subsequent rounds.

This can be seen in the Jordanian FiT experience, where there have been similar debates on the first round tariff. Jordan was the first country in the region to implement a bankable feed-in tariff, which arguably became a regional template. However, as Jordan proceeded to the second round, it replaced the feed-in tariff model with capped-tariff bidding model, where developers bid under capped-tariff set out by the governments and lowest bids win the tendered capacities. As a result, subsequent bidding rounds tend to set a record-low electricity prices. Another example is UAE, where previous success stories lured a new record for world's cheapest solar bid with 2.99 US cents/kwh for a 800 mw of solar-power projects for the Dubai Electricity & Water Authority.

Therefore, it remains a question for Egypt to prove throughout the Round Two FiT whether it is only about procuring lowest figures possible or there is a will to put some opportunity cost investment for an active renewables energy market.

WHO WE ARE

If you have any questions regarding this article feel free to contact:



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- "The firm has been focusing on the big-ticket transactions as a matter of strategy…" (IFLR1000, 2014 edition).

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