Regional Briefing

Renewable Energy in Latin America and the Caribbean

ACORE
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The Renewable Energy Sector's New Frontier: Latin America and the Caribbean

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While most jurisdictions within Latin America and the Caribbean base their core electric generation asset portfolio on fossil fuels,[1] renewable energy technologies are now changing the regional energy landscape. Now, wind, solar, hydro, tidal, and geothermal power plant developers are focusing efforts on transforming Latin America and the Caribbean into more eco-friendly power generators. As a result, local governments have been modifying electric utility regulatory frameworks to accommodate the introduction of renewable energy into regional electric generation and distribution systems.

The renewable energy development activity throughout the region has resulted from a recent two-year "perfect storm" of global energy events. For example, wind power project developers and their tax investors face tax policy uncertainty in the United States. The result is a "choppy" series of boom-and-bust development cycles. Global solar power plant developers, who have been gaining some competitive advantages as a result of declining solar panel and supply-pipeline costs, were dealt a crippling blow in the U.S. after Chinese solar cell manufacturers were levied "anti-dumping" tariffs on products imported into the U.S. Equally, solar power developers have also been affected in the European Union by a threat of high tariffs being imposed on Chinese-manufactured solar panels. Additionally, Spain, which had been a darling of renewable energy developers, retroactively lowered its renewable energy feed-in tariffs and threw the certainty of Europe's renewable energy industry into a tailspin.

CAPITALIZING ON LATIN AMERICAN AND CARIBBEAN MARKETS AND POLICIES

Faced with the downturn and uncertainty in the European and U.S. renewable energy markets, many renewable project developers are turning their attention and development dollars toward Latin America and the Caribbean. The region, which has been plagued with unnaturally high energy production costs, mostly due to the need for expensive, imported, fossil-based bunker fuel and diesel, offers a market where renewable energy can compete directly, on a true economic basis with existing power generators, even without extensive financial subsidies or feed-in tariffs; however, regional governments must be proactive and enact favorable renewable energy regulatory and integration policies. The predictability of such market-based opportunities offers renewable energy developers a long-term, stable development environment where success is largely crafted by economic opportunity based on technology competitiveness rather than ever-changing political and public opinion.

The integration of renewable energy into regional generation portfolios will help achieve individual national and regional security, economic security, and environmental security through the use of local renewable energy resources. As more and more countries in the region assert greater control over energy production costs via renewable resources, susceptibility to variances in imported fuel prices will be minimized, and regional energy-intensive industries will emerge as more competitive on a

[1] With the notable exceptions of Brazil and Costa Rica

global basis. These benefits will also allow the region to attract a greater variety of industries to their markets and permit higher value, more energy-intensive processes to be done locally, thus allowing a greater amount of the value chain to remain at home.

Some countries in the region, such as Mexico, are actively courting renewable energy developers by creating attractive regulatory systems that recognize the unique features of renewable energy production. For example, *Comisión Federal de Electricidad* (CFE), Mexico's national electric utility, is addressing issues of wheeling power, which has often hindered past development of regional renewable power projects. CFE's previous wheeling structure failed to account for wind and solar power's unique characteristics. CFE was penalizing such renewable energy power projects for not producing base-load electricity supply without consideration of the actual value of renewables over fossil fuel power projects. Today, CFE's wheeling arrangements balance the unique characteristics of renewables. CFE has created a system where a renewable energy project can "bank" excess energy production during periods when an off-taker does not require energy from the project, and allows the user to access the "banked" energy during periods when the power project produces insufficient energy to meet the user's needs. Additionally, postage-stamp wheeling charges, earmarked solely for renewable energy, have benefitted renewable energy production. As a result, buyers of renewable power see energy sale rates that compete effectively and directly with fossil fuel-generated energy.

LESSONS LEARNED AND BEST PRACTICES

Renewable energy companies entering the Latin American and Caribbean markets are quickly learning that the potential rewards available in the region are not without their challenges. Successfully navigating jurisdictional, legal, cultural, and business environments is the determining factor as to whether a new market entrant can be successful. Seemingly simple tasks, such as securing site control and permitting, have been the Achilles heel on numerous projects. Projects on the verge of achieving financing have collapsed upon the discovery that negligent or ill-informed actions were taken during the early stages of a project's development, requiring developers to redo their projects' fundamentals.

Mindful of these challenges, successful renewable energy developers in the region have leveraged the lessons learned from previously developed projects in specific countries. The complex project contracting and equity infusion structures developed over the last 20 years are serving today's renewable energy pioneers well by helping them create the most efficient tax structures possible for their projects and, in turn, preserving their projects' rates of return. Given that the Latin American and Caribbean markets do not resemble the U.S. or European markets, knowledge of the terms and structures of existing power project deals specific to the region is essential to achieving early success.

Additionally, many developers have formed joint ventures with local companies to gain market legal and cultural knowledge where possible. Others have reassembled the external legal and technical advisory teams responsible for structuring earlier power project transactions in order to gain valuable market access and knowledge.

CONCLUSIONS AND RECOMMENDATIONS

Given existing high fossil-based Latin American and Caribbean energy prices, renewable energy developers entering the region are finding some of the most lucrative projects anywhere in the world. The ultimate result of the expansion of the renewable energy industry throughout Latin America and the Caribbean will be a "win-win" for developers and investors as well as local consumers. For developers, an expanded renewable energy market and increased equipment demand will continue to drive innovation in the market and lower equipment pricing. For consumers, the inclusion of new renewable energy power projects into their national power generation portfolios will lower overall electricity prices and promote increased

industrialization throughout the region as a result of pricing predictability.

The true litmus test of the feasibility of these renewable energy power projects is whether or not third-party, non-recourse financing is available. In the case of Latin America and the Caribbean, commercial lending institutions are actively looking for lending opportunities to well-structured infrastructure projects throughout the region. Multilateral lending institutions, such as the International Finance Corporation (IFC), the Inter-American Development Bank (IADB), the Central American Bank of Economic Integration (CABEI), and the Development Bank of Latin America (CAF), have become increasingly determined to ensure that renewable energy projects find funding by introducing creative financing structures that also attract interest from the private lending community. In addition to global and regional financing institutions and commercial lenders, development banks, such as FMO (Netherlands), DEG (Germany), Proparco (France), OeEB (Austria), and the Overseas Private Investment Corporation (U.S.), have supported the financing of numerous infrastructure projects that promote certain economic, environmental, or social objectives. Some of these international development banks have even gone as far as prioritizing the region as a lending environment in order to spur the development of renewable energy power projects.

The secret to navigating these rich environments will be assembling the right team armed with market knowledge, language skills, and business acumen.

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