Better Renewables Risk Management Solutions Emerge

Global economic woes have taken their toll, but investment in renewable projects is still strong and since 2010 has surpassed investment in new fossil fuel plants.
But — as a new report by the Economist Intelligence Unit (EIU) of Swiss Re reminds us — as investment grows, so too do the risks involved in owning, managing and operating such installations.
To gain insight into the sector's own estimation of the significant risks involved in renewable projects, the EIU surveyed 280 senior executives in the renewable energy industry. The respondents were based in western Europe (Germany, the UK, Denmark, Spain and Italy), North America and Australia. The results detail the ways that industry executives are managing and reducing risk, the instruments they are using to transfer some of these risks, and the risk management challenges they face.

Renewables Rising

Although just 33 percent of survey respondents said that renewable energy is highly significant for their business strategy today, 61 percent expect this to be the case in three years' time. Almost half (46 percent) of respondents expect annual growth of over 15 percent in their firms' renewable energy investment.

Interestingly, the respondents tended to have the highest growth expectations for the renewable energy technology in which they themselves were actively involved. For example, while 48 percent of the total survey sample expected 'high' or 'very high' growth in installed wind power capacity, among wind energy firms the figure was 73 percent; and while 47 percent of the total sample expected 'high' or 'very high' growth in solar energy capacity, the figure among solar specialists was 86 percent.

Types of Risk

The report identifies several significant types of risk, including building and testing risk; business/strategic risk; environmental risk; financial risk; market risk; operational risk; political/regulatory risk; and weather-related volume.

Of those surveyed, 76 percent identified financial risk as the most significant associated with renewable energy projects. 62 percent identified political and regulatory risk as significant, and 66 percent of respondents involved in wind power mentioned weather-related volume risk.

Early Risks

The general perception among survey respondents was that the earlier stages in the lifecycle of a renewable energy plant are often riskier than the latter stages. Some 24 percent of respondents assessed the financing stage of renewable energy project development as ‘high risk’ – more than any other stage. And 30 percent of respondents from companies with revenue below US$500 million described the overall degree of risk associated with financing a project as ‘high’,

while among larger companies the survey found a lower figure (18 percent).

An investment in renewables grows, so too does the risk (Source: Maxime Dupuis)

Another early type of risk, political and regulatory risk, was identified by 15 percent of survey respondents as a ‘high’ risk, second only to financial risk in importance, while a further 46 percent of respondents rated political and regulatory risk as ‘medium’.

Among the types of risk likely to materialise in the later stages of a project, weather-related risk was, unsurprisingly, rated differently by survey respondents from different renewable energy sectors. Some 18% of respondents from the wind sector described weather-related volume risk as a ‘high’ risk, while 47 percent rated it ‘medium’ risk. But only 7 percent of respondents from the solar sector described weather-related volume risk as a ‘high’ risk, while 41 percent rated it ‘medium’.

Obstacles

The report points to significant obstacles to risk management in the renewables industry. Although 70 percent of respondents say they are successful in identifying risk, fewer are successful at mitigating it (61 percent) or transferring it (50 percent). Obstacles to more effective risk management include restricted availability of both industry data and suitable risk transfer mechanisms.

Many respondents pointed to diversification across geographies and technologies as

the single most powerful tool to mitigate regulatory and weather-related volume risk. And 55 percent of respondents said they mitigate operational risk by relying on proven technologies.

Of the survey respondents, 60 percent use insurance policies to transfer risk to third parties, making it the most common risk transfer mechanism. However, the use of alternative mechanisms such as weather-based financial derivatives appears to be growing, and the renewable energy sector also makes heavy use of service contracts with hardware suppliers to transfer operational risk. But some executives told the EIU that they retain regulatory and weather-related volume risk because they see few cost-effective alternatives.

According to the report, 38 percent of executives expect to make additional use of financial derivatives to transfer risk over the next three years, and 34 percent special purpose vehicles and 55 percent insurance. Renewable energy executives told the EIU that they expect wider availability of more standardised products, notably weather derivatives, insurance and hedging contracts.

Conclusions

Based on the survey, the report offers several recommendations, most importantly that companies should intensify their efforts to reduce and mitigate risk. Even so, given that effective risk transfer products are limited in availability developers should focus on mitigating specific risks and on reducing general business risk — for example, by sharing risk with joint venture partners, or by investing in late stage developments. The report also advises companies to focus on industry collaboration and partnerships as a way of reducing risk. Companies might pool information or spares, or jointly collect relevant weather data.

Finally, the report advises renewable power developers to foster industry expertise and product development. The EIU believes that more comprehensive information and data on renewable energy technologies, together with industry education programmes, may enable the development of expertise both within the renewable energy sector and among external stakeholders, potentially paving the way for more available and effective risk transfer products.

www.renewableenergyworld.com [1]

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