

# REturn to uncertainty

Policy blues, tariff caps mean capacity additions in renewable energy are set to fall well short of the 2022 goal

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India’s installed capacity in renewable energy (RE) could increase by just 40 GW to 104 GW by fiscal 2022 from 64.4 GW in fiscal 2019, because of enduring policy uncertainty and tariff glitches.

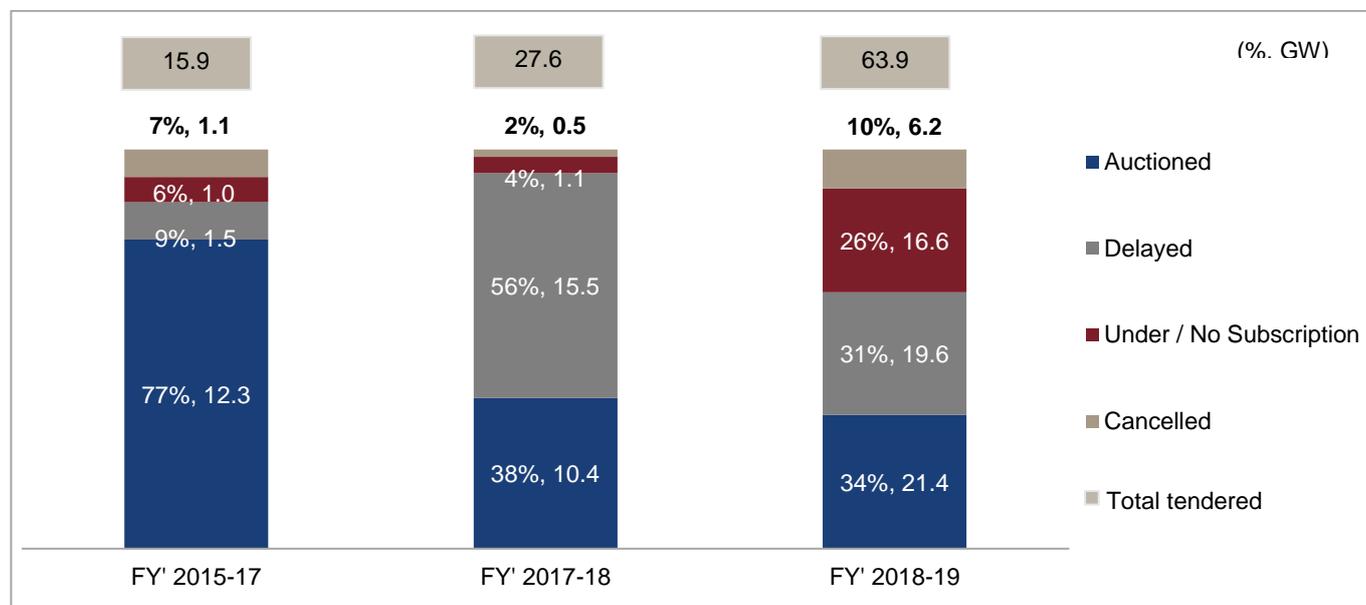
That would be a good 42% short of the government’s target of 175 GW.

The sector has witnessed a material waning of developer interest last fiscal. A sizeable 26% of the 64 GW of projects that were auctioned by the Centre and states received no or lukewarm bids, and another 31% faced delays in allocation after being tendered.

Thus, despite the increase in tendering volume, not only has allocation of projects slowed down, but both undersubscriptions and cancellations of awarded tenders have also increased.

As a result, the ratio of auctioned or awarded projects to tendered projects plunged to 34% in fiscal 2019 from 77% over fiscals 2015-16 and 2016- 2017 (cumulative).

**Ratio of auctioned projects to total projects declines**



*Note: Tendering excludes EPC, open access, captive, and distributed generation projects.*

*Source: CRISIL Research*

**Policy uncertainty short-circuits RE goals**

CRISIL Research believes that the unstable policy environment poses a big risk for the country’s RE targets. This is evident in the growing incoherence between the policy thrust on RE, on the one hand, and the actual action by implementation agencies like the Solar Corporation of India (SECI) and state distribution companies, on the other.

A prime example is the ongoing issue of tariff renegotiation in Andhra Pradesh, a leading state for RE in the country. At the end of July 2019, the state’s discoms owed ~Rs 2,600 crore to RE generators, part of which was because the state government had been delaying payments over a tariff dispute. Such prolonged payment delays and disputes not only set a negative precedent, but also put at risk existing and planned investments. Similarly, the Rajasthan government’s recent draft solar and hybrid policy proposes an additional annual levy of Rs 2.5 lakh-Rs 5 lakh per MW on all projects that sell power to entities outside the state. Should this be implemented, it could be highly

detrimental for the growth of RE capacities given that Rajasthan is one of the most sought-after states for solar power plants.

Further, CRISIL Research data shows that central agencies have also acted in a similar fashion, where they cancelled post renegotiation 4.4 GW of contracts as against 0.1 GW by state distribution companies (discoms) in fiscal 2019. For instance, SECI terminated its 2,400 MW ISTS Tranche II solar scheme as the bid tariff of Rs 2.64 was higher than expected. In addition, another 1.7 GW of contracts were cancelled without renegotiation, citing high tariffs.

## **Tariff caps becoming a new challenge for developers to navigate**

Developers are also increasingly losing interest as central and state power discoms are increasingly lowering tariff caps, which is constraining project viability and resulting in renegotiation of tenders, where counterparties disagree on pricing. The Bhadla Solar Park in Rajasthan, which saw tariff bids of Rs 2.44 per unit in May 2017, has become a benchmark of discom expectations on tariff bids today, resulting in a solar tariff cap of around Rs 2.5-Rs 2.6 per unit.

Wind energy projects, meanwhile, are facing even greater turbulence. Their viability has reduced following the shift from fixed tariffs to competitive bids, and also because of an increase in capital costs with bleeding original equipment manufacturers no longer discounting equipment. The result is, there is hardly any bidding for fresh wind energy projects today.

Incidentally, the solar tariff cap fell to Rs 2.65 per unit in June 2019 from Rs 2.93 per unit in December 2018, while the wind tariff cap dropped to Rs 2.83 per unit in May 2019 from Rs 2.93 per unit in April 2018. Yet, several factors affect the viability of solar projects, such as land acquisition cost and technical factors such as irradiation or wind density levels, apart from capital and funding costs. More crucially, the counterparty risk arising from elongated payment cycles – this can range from 3-4 months for financially strong discoms such as Gujarat Urja Vikas Nigam Ltd to as long as 9-10 months for weaker state utilities such as those in Andhra Pradesh – has exacerbated the developers' working capital cost in recent times.

CRISIL Research's analysis shows that a sharp narrowing of the gap between tariff caps and actual bid tariffs has left little headroom for developers, especially as capital costs have remained relatively constant and developers factor in a counterparty risk premium owing to payment delays of 4-6 months on average by the state discoms.

## **Course correction crucial to improve capacity addition**

CRISIL Research expects the installed capacity to only increase gradually. That's because the government needs to resolve the twin issues of tariff caps and policy incoherence to restore developer confidence and stem the fall in subscriptions to achieve its installed capacity targets.

The RE sector requires investments of ~Rs 2.6 lakh crore over the next five years as per CRISIL Research's outlook. With interest from global investors remaining strong, CRISIL Research believes that funding is not a significant risk provided government policy is consistent.

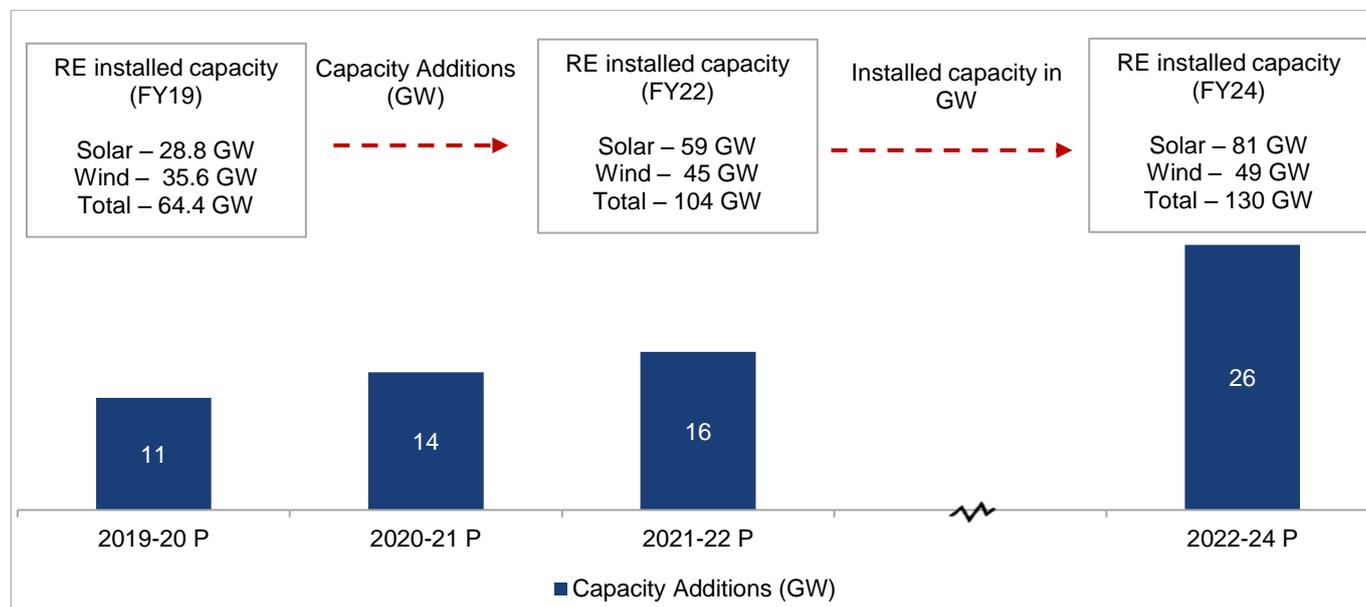
One of the ways to improve the current environment is to relax the tariff caps as this could help improve viability and attract new players. On the other hand, if solar tariffs remain capped at Rs 2.5-2.6 per unit, the market could continue to be confined to a few developers, who may be constrained to invest in fresh expansions.

Also, the government needs to provide a consistent and stable policy environment, especially as prolonged disputes can hamper the projects' debt-servicing ability, impacting player-level interest and denting investor confidence. There needs to be enhanced cooperation between the centre and state authorities with a mutual resolve to promote clean

energy, given that it now costs significantly less than conventional power. Besides, some policies such as renewable purchase obligations and penalties for delays in payments can be formalised by including them in the Electricity Act.

The resolution of the above mentioned policy risks would provide a fillip to the sector, posing an upside to the current estimate of 104 GW installed capacity by fiscal 2022, as per CRISIL Research.

**How the wind could blow**



P: Projected

Note: Capacity addition outlook and installed capacities are only for solar and wind energy.

**Analytical contacts**

**Miren Lodha**

Director, CRISIL Ltd  
miren.lodha@crisil.com

**Mayur Patil**

Associate Director, CRISIL Ltd  
mayur.patil@crisil.com

**Surbhi Kaushal**

Manager, CRISIL Research  
surbhi.kaushal@crisil.com

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