Finance and Public Administration Committee

Budget Scrutiny 2022-23

Correspondence from the Cabinet Secretary for Net Zero, Energy and Transport to the Convener of 9 February 2022

Dear Kenneth,

2022-23 Scottish Budget – information regarding ScotWind

Further to the Cabinet Secretary for Finance and the Economy, Kate Forbes', session with the Committee on 1 February, and members' interest in ScotWind, I wanted to offer a specific response to members' questions concerning ScotWind.

ScotWind is the world's largest commercial round for floating offshore wind and puts Scotland at the forefront of offshore wind development globally. We already have the world's largest operating commercial floating wind farm and ScotWind now breaks new ground in putting large-scale floating wind technology on the map at gigawatt scale.

ScotWind leasing is managed by Crown Estate Scotland (CES) on behalf of Scottish Ministers, and the administration of seabed leasing is a matter for CES. As set out in the Crown Estate Scotland framework document (Crown Estate Scotland: framework document - gov.scot (www.gov.scot)) the Chief Executive, as the Accountable Officer for CES, has responsibility for ensuring that CES resources are used economically, efficiently and effectively, and that arrangements are in place to secure Best Value for the organisation and to deliver value for money for the public sector as a whole, in line with the requirements of the Scottish Public Finance Manual.

CES advise that the ScotWind leasing programme was developed within the context of the GB electricity market, whereby private developers develop and operate generation assets. Furthermore, projects in Scottish waters are at a competitive disadvantage (compared to projects further south) as a result of higher capital and transmission costs.

ScotWind has made available Option Agreements for areas of seabed, for which developers were invited to apply (on a competitive basis). For the option period (typically 10 years), successful ScotWind applicants will pay an option fee (on a one-off, upfront basis) of up to £100,000/km2 of seabed awarded – that option fee gives them rights to develop (not build) a windfarm on the site.

During the option period, developers undertake a number of activities at risk. These include:

i. fully designing the windfarm
ii. gaining the necessary planning consents
iii. successfully applying for a Contract for Difference (CfD) and
iv. financing construction of the project

Only developers that meet all the Option Agreement requirements, including gaining consent for their project, can be granted a lease to allow construction to commence. If they are successful, developers will pay rent to CES during the lease period. The modelled rent level represents c2% of gross project revenues.

CES has an obligation to transact at 'market value' (as outlined in The Scottish Crown Estate Act 2019). This market value test formed a fundamental aspect of the development of the ScotWind leasing programme. There are two key aspects of the financial returns to CES (and therefore to SG): option fees and rent. Each was subject to market value testing during development. Expert external advice was procured to advise on pricing aspects to CES during this development.

In early 2021 a leasing review was agreed with Scottish Ministers and was undertaken by CES to ensure the pricing structure reflected recent changes in the UK offshore wind market. Scottish Ministers were kept abreast of this review by CES and as a result of the review several changes were made, including a ten times increase in the level of option fees charged.

Change of control provisions were also strengthened to ensure a proportion of any 'premium' arising from an option sale can be recovered by CES. This revenue will be passed to Scottish Government for public spending ensuring that the public benefits financially from any secondary trading of Option Agreements, especially during the initial years.

As stated, expert external advice was procured to advise on pricing aspects to CES during the development of ScotWind Leasing. Calculating an accurate net present value for projects in Scotland is challenging at this stage given the lack of insight into project design, the actual cost of capital each developer faces, and uncertainties regarding long-term revenue streams. Financial modelling of 'typical' Scottish and other UK offshore wind projects was carried out during ScotWind development, which included exploring the relative cost competitiveness of a project in Scottish waters.

Grid connection challenges were identified as an additional cost for the development of Scottish projects and factored into the thinking for ScotWind to ensure it could provide maximum deliverability.

This process has produced a leasing round focused on quality and deliverability of bids and the long term prize of supply chain investment that

promises to transform the Scottish economy over decades and to provide the energy transition required to achieve Net Zero by 2045.
The Scottish Government will use every lever within our devolved competence to support and grow the offshore wind supply chain here in Scotland to maximise investment and build a lasting legacy for Scotland's supply chain. Each application to the ScotWind leasing round was required by CES to include a Supply Chain Development Statement (SCDS) setting out its supply chain commitments through the various stages of each project.

CES' initial analysis of the information held within each SCDS provided by each consortium indicates that the successful ScotWind bidders have committed to invest at least £1 billion in the Scottish supply chain for every gigawatt of power generated. In order to comply with procurement regulations, lease awards were not contingent on the content of these development statements, however, checks and balances are in place.

We are determined to help create an environment which ensures consortia deliver on their commitments and the SCDS terms and conditions make clear that beyond a certain point in the project development process failure by developers to deliver on their commitments will trigger remedies ranging from financial penalties to withholding of a seabed lease. Once Lease Option Agreements are signed by the projects, the SCDS outlooks will be published on an annual basis.

As Ms Forbes stated at the Committee session on 1 February, a prudent estimate of ScotWind fees was identified within the £620 million of additional funding for next year's budget. These monies support the 2022-23 budget and underpin projects set out within the budget in line with the Programme for Government commitment to invest some of the ScotWind revenues to help tackle the twin crises of biodiversity and climate change as we transition to Net Zero.

I hope that the Committee finds this update helpful.

Yours sincerely

Michael Matheson