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Mexico's renewable energy call hits crucial phase

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Pedro Niembro

Mexico's call for investment in wind and solar power projects in partnership with state-owned utility [CFE](#) is moving to a decisive stage amid unprecedented levels of private-sector interest.

BNamericas spoke to Pedro Niembro, senior advisor at Mexico City-based business advisory firm Monarch Global Strategies, about the risks and returns for investors in the mixed scheme, the outlook for

negotiations with CFE for all-important power purchase agreements, and the types of sponsors that are best placed to compete.

BNamericas: How much interest are you seeing from private-sector companies in participating in the mixed-scheme tender?

Niembro: A lot. CFE was looking for about 7GW of proposals for projects. It has received proposals for 38GW.

It is an attractive scheme. It is different from the traditional model for developing investment projects. The mixed scheme is more like an infrastructure development contract than a traditional PPA [power purchase agreement]. It is a structured financing scheme with capped returns, but it gives partners a lot of visibility on those returns.

The transfer of assets to CFE [when the returns are achieved] is something I do not especially love, because the residual value of the project will end up being incorporated into the PPA. But developers will be able to anticipate how their returns will work. I think that there will be some very satisfied investors.

BNamericas: How clear are the selection criteria?

Niembro: The projects all have to be aligned with the energy ministry's binding planning process. That is a good thing because the projects will be defined by the needs of the system and executed through structured partnerships with authorities. It is not a market-driven scheme. It is more of a planning-led model. This reduces risks for developers.

BNamericas: What sort of companies do you think will be selected?

Niembro: I expect CFE will go for solid projects that have been submitted by well-known investors with access to cheaper capital and funding.

The selection will not be based just on the price of the PPA. The experience and the capabilities of the company to execute a project on time will also be important. That is where there will be a lot of differentiation.

It is not for everyone. It is not for opportunistic funds with short timelines for maturing their investments. If you are looking just to purchase assets and sell them in five years, it will not be that interesting. But for solid companies that really inhabit this sector and have experience operating the assets, then it is a very attractive opportunity.

BNamericas: What are the main concerns of clients who are involved in the call?

Niembro: One of their main concerns is that the oversubscription to the process will provide a lot of leverage to CFE for negotiating the PPA. CFE will provide a PPA for 70% of the capacity. It will be the anchor client for every project. The term of the PPA is one of the aspects to be negotiated. It will allow projects to obtain an attractive but "fair" enough return at the negotiated price, according to what the authorities deem fair. We expect to see 15–25-year PPAs, after which the generation facility will be transferred to CFE.

The PPA negotiations will be key. CFE will want to drive down the price of the PPA.

From sources within the authorities, I know that they are qualifying about 13GW for investment. That means that projects in the same region will be competing against each other to meet the best conditions for CFE.

BNamericas: Will the PPA from CFE be enough by itself to make a project bankable?

Niembro: That will depend on the region. For example, projects in industrial corridors in the Bajío or around Monterrey will find many opportunities to allocate the 30% that will be allowed to go to market.

Some other projects, especially in the Yucatán, will find that quite challenging.

CFE [recently signed](#) the first PPAs with [Copenhagen Infrastructure Partners](#) for 900MW plus 450MW of BESS of merchant projects on the peninsula. That is promising. CIP signed a PPA with CFE's subsidiary for qualified users, so CFE will be responsible for looking for clients in the market.

BNamericas: What are the main risks to the private partners in the mixed scheme?

Niembro: A lot of the development risks are reduced by having the PPA for 70% of the capacity. The main financial risk will be derived from the leverage that CFE will have in the PPA negotiations.

Another major risk is that the Mexican grid is constrained. If transmission lines are not built quickly, there could be curtailment due to congestion, reliability or grid stability issues.

Risk allocation will be a game changer. There are still a lot of moving parts. CFE will help expedite the permits, but if a developer does not build a solid relationship with surrounding communities, that could derail a project through injunctions, for example.

BNamericas: Is curtailment a major risk in Mexico?

Niembro: The Sheinbaum administration understands what the grid needs. CFE has just [announced](#) the first of a series of major tenders for transmission lines. The whole grid will be upgraded over the next few years.

At the same time, we expect Sener [the energy ministry] and Cenace [the transmission system operator] will recognize and pay for the services that batteries provide to support the grid.

When developers build a renewable energy project in Mexico, there will have to be some kind of storage element attached.

One idea [being floated](#) is that instead of having separate BESS within each project, there could be consolidation of regional projects with one large battery system attached. In terms of grid reliability management, that could be a better way to provide frequency regulation and other services to the system than having small battery storage systems scattered across different projects.