Parliamentary Budget Office

Policy costing

Energy Security and Modernisation Fund	
Party:	Australian Labor Party

Summary of proposal:

This proposal would establish an Energy Security and Modernisation Fund (the Fund) with $5 billion to be drawn down as follows.

	2019 –20	2020 –21	2021 –22	2022 –23	2023 –24	2024 –25	2025 –26	2026 –27	2027 –28	2028 –29	2029 –30
$ million	710	290	580	1,000	690	850	380	230	270	-	-

Returns from investments would not be reinvested in the Fund. The Fund would have a mandate consistent with the Clean Energy Finance Corporation (CEFC), as announced in the 2011-12 Mid-Year Economic and Fiscal Outlook (MYEFO), however the interest rate and loan terms would be as per the Northern Australia Infrastructure Facility, as announced in the 2015-16 Budget. The funding would be allocated to energy network projects, including interconnectors, supporting gas pipelines and new network infrastructure.

The Fund would be administered by the CEFC.

The proposal would have effect from 1 July 2019.

Costing overview

The proposal would be expected to decrease the fiscal balance by $620 million, increase the underlying cash balance by $170 million, and decrease the headline cash balance by $2,220 million over the 2019-20 Budget forward estimates period.

A breakdown of the financial implications of this proposal from 2019-20 to 2029-30 is provided at Attachment A. The proposal would be expected to have an ongoing impact beyond the 2019-20 Budget forward estimates period.

Consistent with Parliamentary Budget Office (PBO) Guidance 02/2015, public debt interest (PDI) expense impacts have been included in this costing because the concessional loans provided under this proposal involve financial asset transactions.

The impacts on the fiscal, underlying cash and headline cash balances differ due to the treatment of the concessional nature of the loans, and the flow of loans and principal repayments. Only the fiscal balance captures the estimates of expenses and unwinding income relating to the concessional loan discount, and only the headline cash balance captures changes in loans issued and principal repayments. A note on the accounting treatment of concessional loans is included at Attachment B.

The estimates in this costing are particularly sensitive to the funding profile, and the availability and timing of appropriate projects that would be eligible for financing from the Fund. They are also subject to uncertainty around the actual loan terms and repayment rates and are sensitive to projected Commonwealth Government bond rates. Fiscal balance impacts, reflecting the upfront concessional loan discount and the subsequent unwinding of these discounts, could differ from those presented in this costing should the actual market rate differ from those specified for this costing.

Table 1: Financial implications ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Fiscal balance	-220	-50	-130	-220	**-620**
Underlying cash balance	10	30	50	80	**170**
Headline cash balance	-680	-230	-480	-840	**-2,220**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.
(b) Figures may not sum to totals due to rounding.

Key assumptions

The PBO has made the following assumptions in costing this proposal.

- The terms under which loans are issued, including the concessional rate of interest and the loan period (excluding the interest-free period), reflect those used for modelling the Northern Australia Infrastructure Facility.
- As per the CEFC, funds would not be drawn down from the Consolidated Revenue Fund until loans are to be provided.
- The profile for the provision of loans for projects is as specified by the requestor with the last tranche released in the ninth year.
- Given the nature of projects financed by the Fund (energy network infrastructure), loans would likely be issued to investment grade institutions, and default rates would be relatively low at 1.5 per cent.
- Write-downs or write-offs of bad debts would occur only after half-way through the loan terms and, as the average loan term exceeds the costing horizon, these do not appear in the costing estimates.

Methodology

A concessional loan model, based on the Department of Finance Accounting for Concessional Loans policy guidelines, was used to estimate the financial implications of loans under the proposal. This includes the effect on administered expenditure and revenue.

The terms for loans under the Fund and the concessional interest rates were sourced from the 2015-16 Budget measure *Developing Northern Australia — Northern Australia Infrastructure Facility*. The value and timing of loans were based on the expenditure profile specified by under the proposal.

The impact on departmental expenses for the Fund was based on departmental funding for similar activities.

All estimates have been rounded to the nearest $10 million.

Data sources

Department of Finance, 2016. *Accounting for concessional loans, Resource Management Guide No. 115* [Online] Available at https://www.finance.gov.au/sites/default/files/rmg-115-accountingforconcessional-loans.pdf [Accessed 04.04.2019].

Reserve Bank of Australia, 2018. *Financial Stability Review April 2018* [Online] Available at https://www.rba.gov.au/publications/fsr/2018/apr/pdf/financial-stability-review-2018-04.pdf [Accessed 04.04.2019].

The Department of the Treasury provided the 2015-16 Budget measure *Developing Northern Australia — Northern Australia Infrastructure Facility* costing model.

The Department of the Treasury provided economic parameters as at the 2019 Pre-election Economic and Fiscal Outlook.

Attachment A – Energy Security and Modernisation Fund – financial implications

Table A1: Energy Security and Modernisation Fund – Fiscal balance ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	Total to 2022–23	Total to 2029–30
Revenue													
Income from unwinding of discounts	*10*	*20*	*20*	*40*	*50*	*60*	*70*	*70*	*70*	*70*	*70*	***90***	***560***
Interest accrued on loans	*30*	*50*	*80*	*120*	*150*	*190*	*200*	*200*	*210*	*200*	*190*	***280***	***1,630***
Total – revenue	**40**	**70**	**100**	**160**	**200**	**250**	**270**	**270**	**280**	**270**	**260**	**370**	**2,190**
Expenses													
Concessional loan discount expenses	*-240*	*-100*	*-200*	*-340*	*-230*	*-290*	*-130*	*-80*	*-90*	*-*	*-*	***-870***	***-1,690***
Departmental	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	***-40***	***-110***
Total – expenses	**-250**	**-110**	**-210**	**-350**	**-240**	**-300**	**-140**	**-90**	**-100**	**-10**	**-10**	**-910**	**-1,800**
Total (excluding PDI)	**-210**	**-40**	**-110**	**-190**	**-40**	**-50**	**130**	**180**	**180**	**260**	**250**	**-540**	**390**
PDI impacts	**-10**	**-10**	**-20**	**-30**	**-50**	**-60**	**-80**	**-80**	**-80**	**-70**	**-80**	**-80**	**-560**
Total (including PDI)	**-220**	**-50**	**-130**	**-220**	**-90**	**-110**	**50**	**100**	**100**	**190**	**170**	**-620**	**-170**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.

Table A2: Energy Security and Modernisation Fund – Underlying cash balance ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	Total to 2022–23	Total to 2029–30
Receipts													
Interest payments received on loans	*30*	*50*	*80*	*120*	*150*	*190*	*200*	*200*	*210*	*200*	*190*	***280***	***1,630***
Total – receipts	**30**	**50**	**80**	**120**	**150**	**190**	**200**	**200**	**210**	**200**	**190**	**280**	**1,630**
Payments													
Departmental	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	***-40***	***-110***
Total – payments	**-10**	**-10**	**-10**	**-10**	**-10**	**-10**	**-10**	**-10**	**-10**	**-10**	**-10**	**-40**	**-110**
Total (excluding PDI)	**20**	**40**	**70**	**110**	**140**	**180**	**190**	**190**	**200**	**190**	**180**	**240**	**1,520**
PDI impacts	**-10**	**-10**	**-20**	**-30**	**-50**	**-60**	**-80**	**-80**	**-80**	**-70**	**-70**	**-70**	**-560**
Total (including PDI)	**10**	**30**	**50**	**80**	**90**	**120**	**110**	**110**	**120**	**120**	**110**	**170**	**960**

(a) A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

Table A3: Energy Security and Modernisation Fund – Headline cash balance ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	**Total to 2022–23**	**Total to 2029–30**
Receipts													
Interest payments received on loans	*30*	*50*	*80*	*120*	*150*	*190*	*200*	*200*	*210*	*200*	*190*	***280***	***1,630***
Principal repayments on loans	*20*	*30*	*50*	*80*	*110*	*140*	*150*	*160*	*160*	*160*	*160*	***190***	***1,230***
Total – receipts	**50**	**80**	**130**	**200**	**260**	**330**	**350**	**360**	**370**	**360**	**350**	**470**	**2,860**
Payments													
Loans issued	*-710*	*-290*	*-580*	*-1,000*	*-690*	*-850*	*-380*	*-230*	*-270*	*-*	*-*	***-2,580***	***-5,000***
Departmental	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	*-10*	***-40***	***-110***
Total – payments	**-720**	**-300**	**-590**	**-1,010**	**-700**	**-860**	**-390**	**-240**	**-280**	**-10**	**-10**	**-2,620**	**-5,110**
Total (excluding PDI)	**-670**	**-220**	**-460**	**-810**	**-440**	**-530**	**-40**	**120**	**90**	**350**	**340**	**-2,150**	**-2,250**
PDI impacts	**-10**	**-10**	**-20**	**-30**	**-50**	**-60**	**-80**	**-80**	**-80**	**-70**	**-70**	**-70**	**-560**
Total (including PDI)	**-680**	**-230**	**-480**	**-840**	**-490**	**-590**	**-120**	**40**	**10**	**280**	**270**	**-2,220**	**-2,810**

(a) A positive number for the headline cash balance indicates an increase in receipts or a decrease in payments or net capital investment in headline cash terms. A negative number for the headline cash balance indicates a decrease in receipts or an increase in payments or net capital investment in headline cash terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.

Attachment B – Accounting treatment of concessional loans

A concessional loan is a loan provided on more favourable terms than the borrower could obtain in the financial market. The most common concession is a below-market interest rate, but concessions can also include favourable repayment conditions. The income contingent loans available through the Higher Education Loan Program are an example of concessional loans offered by the Commonwealth.

Budget impact[1]

The accounting treatment of concessional loans differs across each budget aggregate. The underlying cash balance only captures actual flows of interest related to the loans. The headline cash balance captures actual flows of principal as well as interest. The fiscal balance captures accrued interest, the value of the concession and any write-offs related to the loans. The interest cost of financing these loans is captured in all budget aggregates, and is separately identified by the PBO.[2] (Table B1 provides information about the detail provided in a costing.) The provision of concessional loans decreases the Commonwealth Government's net worth if the liabilities issued (the value of Commonwealth Government Securities (CGS) issued to finance the loans) are greater than the assets created (measured at their 'fair value' or price at which the loans could be sold).

Treatment of debt not expected to be repaid

All budget aggregates take into account estimates of the share of loans not expected to be repaid when calculating interest flows and estimating the value of the concession that is being provided. None of the measures capture the direct impact on net worth of the loans not expected to be repaid. If a portion of loans are not expected to be repaid, estimates of the 'fair value' of the loans outstanding will be reduced. Such reductions, both when loans are issued and if loans are subsequently re-valued, are recorded in the budget under 'Other economic flows' which are reflected in net worth but not in the budget aggregates.

Table B1: Components of concessional loan financial impacts in costing proposals

Budget item	Appears in	Comments
Interest accrued or received	All budget aggregates	Captures the interest accrued or expected to be received on the fair value of the debt. (The budget cannot include interest income on a debt that is not expected to be repaid.)
Concessional loan discount expense and unwinding revenue	Fiscal balance	The net present value of the concession (based on the difference between the market and concessional interest rates) is captured as an expense in the fiscal balance. As loans are repaid, the remaining value of the concession reduces, so this expense is 'unwound' with a positive impact on the fiscal balance. The concessional discount and its unwinding are not recognised in cash balances as there is no cash inflow or outflow.
Write-offs	Fiscal balance	Debt forgiveness, also known as mutually agreed write-downs (for example in the case of the death of the borrower of a HELP loan) are expensed when they occur, reducing the fiscal balance. These transactions do not affect the cash balances as no cash flows occur.
Initial loan; principal repayments	Headline cash balance	Higher estimates of loans not expected to be repaid lowers principal repayments. These transactions are not included in the fiscal balance or underlying cash balance as they involve the exchange of one financial asset (loan) for another (cash).
Public debt interest (PDI)	All budget aggregates	The PDI impact is the cost of the change in the government's borrowing requirements to fund the loans. The net headline cash balance impact excluding PDI is used to estimate the proposal's impact on PDI payments.

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[1] The PBO's treatment of these loans is consistent with the Department of Finance costing guidelines.
[2] This is in accordance with PBO Guidance 02/2015 and the Charter of Budget Honesty Policy Costing Guidelines which specify that costings of proposals that 'involve transactions of financial assets' need to take into account the impact on PDI payments.