Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates

2014 - 2015

Department/Agency: Treasury
Question: AET 275-287
Topic: Clean Energy Finance Corporation (CEFC)
Reference: written - 06 March 2015
Senator: Dastyari, Sam

Question:

275. The CEFC quarterly report for the December 2014 quarter shows a $74.5 million 'climate bond' investment: what is this, what will it achieve for clean energy and carbon pollution abatement, and what the expected return will be?
276. Have levels of investment met expectations, or have outside influences affected the demand for loans and other support?
277. What rates of return are you expecting from your portfolio in the medium term? Have these expectations changed?
278. What is in the investment pipeline for the CEFC?
279. In a speech last year, the now Parliamentary Secretary for the Environment, Bob Baldwin, said in a speech at the Clean Energy Week Conference that the government was determined to press on with abolishing the CEFC as the government could not, or cannot, support the CEFC providing "concessional" finance to projects that he termed "too risky for the private sector": is the CEFC is providing concessional finance to projects too risky for the private sector?
280. If not, how would you describe what the CEFC is doing?
281. I note that the now Parliamentary Secretary for the Environment was contradicted within hours in a speech given at the very same forum by Minister Hunt who said that while it may not have been the Government's preference for the CEFC to continue to operate, the organisation was clearly going to continue to do its work and that given this reality it was good to see the CEFC focusing on developing financing products for energy efficiency projects and also the leasing of solar systems: has the work of the CEFC been in anyway affected by the uncertainty produced by the current Government's abolitionist and contradictory attitudes to the CEFC, noting the abolition bill remains on the notice paper?
282. Have you had any update from the government has to their current plans for the CEFC?
283. How much money would the closure of the CEFC save the budget?
284. Will there be a cost to the budget from closing the CEFC?
285. How will the public policy outcomes and benefits to the economy of provided by the CEFC be delivered if the CEFC is abolished by the Government?
286. How effectively does the work of the CEFC – funding innovative projects – link with the objectives of Direct Action, which seeks carbon abatement through funding innovative projects?
287. (All things being equal) what total contribution to Australia's 2020 emissions reduction target will the CEFC make if it is not abolished?

Answer:

275. The CEFC committed $74.5 million to cornerstone National Australia Bank's (NAB) green bond issuance - a first of its kind in the Australian domestic market.

The NAB Climate Bonds are senior unsecured NAB corporate bonds for financing a portfolio of renewable energy assets and facilities in Victoria, South Australia, Tasmania, Western Australia, NSW and the ACT. The CEFC's investment will finance projects that meet the CEFC's investment eligibility criteria.

The international green bond and climate bond markets are growing rapidly and providing a way for investors to support the acceleration of renewable energy technology uptake. Bond-type finance is important for attracting institutional investors (such as pension funds and superannuation funds).

While climate bonds were available overseas, this is the first Australian-issued bond in the Australian market for projects that are Australian based. Australia's superannuation investment pool is worth more than $1trillion AUD and attracting these funds into clean energy technology investment in Australia is vital for the further development and growth of the industry. Eligibility of a project for financing under the bond is determined with reference to the Climate Bond International Standards and Certification Scheme, so that investors can be sure they are financing low emissions projects.

The market response to the NAB bond offer was oversubscribed (a total of $300 million versus initial estimates of $150 million).

The forecast lifetime yield on the NAB Climate Bonds investment is 4.1%.

Expected rate of return includes all projected income from the investment, is based on assumptions made at the time the investment is committed, and as such is an indicative forecast only, given variables such as potential for material movement in assumptions between time of contractual and financial close, establishment fees and costs, floating rates, penalty fees, early repayment fees, etc. Each investment's rate of return is expressed as an annual yield, and is calculated over the lifetime of the investment.

Further information on this CEFC investment can be found at: http://www.cleanenergyfinancecorp.com.au/media/releases-and-announcements/files/cefc-commits-up-to-$75m-as-cornerstone-investment-in-nab%E2%80%99s-australian-dollar-climate-bond-issue.aspx

276. Since the CEFC began operations, the Corporation has received proposals from over 150 project proponents seeking CEFC finance of approximately $4 billion (for total project costs of around $11 billion).

In that time the CEFC has committed funds of more than $1 billion to projects worth more than $3.4 billion.

The CEFC has previously placed on the record the impact of the ongoing uncertainty around the CEFC's future, and of the presently subdued demand for renewable energy investment and energy market investment generally, based on market and policy factors such as excess supply in the NEM, the outcome of negotiations on the RET, the Energy White Paper process, the Emissions Reduction Fund, and changes to state legislation and initiatives.

Market interest in energy efficiency to reduce energy input costs and insulate businesses against possible increases in domestic gas prices is strong, and the CEFC is active in this market.

277. Under its legislation, the purpose of the CEFC is to facilitate increased flows of finance into the clean energy sector. Under the CEFC Act and Investment Mandate, the CEFC is to apply commercial rigour when making investment decisions, target a benchmark rate of return, and operate with a commercial approach.

As reported in the CEFC Annual Report 2013/14 (pages 26-27), the CEFC achieves different appropriately risk-adjusted returns across different types of finance, counterparties and sectors. For example, yields range from above 8 per cent for equity investments and project finance, and around 5 per cent for co-finance partnerships, or below, where financing is directed into the small-to-medium sized business, government or not for profit sectors through co-finance partners.

The CEFC portfolio return is expected to change to reflect market conditions in the energy sector. Many utility scale projects have payback periods of 10 to 20 years or more and the observed market conditions are that investors will not commit to capital funding investments while policy settings remain in flux.

Accordingly, the CEFC expects no growth in the share of its portfolio in Project Finance for utility scale solar PV by end of the 2014/15 financial year, and a contraction in the share of its portfolio dedicated to Project Finance for utility scale wind.

The CEFC expects Corporate Lending for larger scale bioenergy, energy efficiency and commercial scale rooftop solar PV to grow, as well as expansion in co-financing for these purposes.

The overall effect is that, as Project Finance investment opportunities in utility scale renewables (wind and solar PV) contract, we expect the CEFC’s lifetime portfolio yield to fall from about 7% (as at 30 June 2014) to between 5-6% at 30 June 2015 which is 2-3% above the current weighted average five year long-term government bond rate for investments made.

278. Since the CEFC began operations, we have received proposals from over 150 project proponents seeking CEFC finance of approximately $4 billion (for total project costs of around $11 billion).

The CEFC operates commercially and we are not able to comment on any specific commercial discussions we may have underway with clients.

However, in general terms we have a range of potential projects in the pipeline, including:

- Bioenergy and waste to energy, including for export;
- New co-finance programs to help accelerate the take-up of energy efficient equipment, transport and solar PV;
- Investments by universities and public sector institutions to deliver operational savings from improved energy efficiency and renewables;
- Enabling infrastructure and services for uptake of low carbon transport like electric vehicles and hydrogen fuel cell vehicles;

Not all of these will go ahead of course and of those that do proceed, we only expect some to close by the end of this financial year.

279-280. The CEFC is not making loans “too risky for the private sector” and neither is it “providing concessional finance to projects too risky for the private sector”.

The CEFC is a responsible investor and in line with its ministerial direction applies commercial rigour when making its investment decisions.

As part of the 2013 Investment Mandate, the CEFC was charged with having an acceptable but not excessive level of risk relative to the sector.

All investment has risk, as without risk there can be no return. The transactions the CEFC undertakes are typically secured against equipment, projects or the borrowing entity. As reported in its latest Annual Report for 2013/14, the Corporation’s portfolio of investments has an overall average shadow credit rating of BB. The 2015 Investment Mandate effectively caps the level of portfolio credit risk at this level.

There is no inherent relationship between the concessionality provided in any transaction and the credit risk of the counterparty.

Most of the CEFC’s investment portfolio is comprised of Project Finance loans which exhibit a credit profile that matches those held by private sector banks also providing such facilities. While the Investment Mandate allows the CEFC to offer up to $300 million of concessional discount on loans per year, since inception the CEFC has only granted approx. $11.5 million of concessional discount.

Across all the commitments the CEFC has made, totalling over $1 billion, concessionality has been used very sparingly and only to achieve a public good (e.g.: co-finance directed at local government, small business or the not-for-profit sectors) while still earning an appropriate risk adjusted return for the taxpayer that exceeds the Australian Government’s costs of funds.

281. Whether or not the CEFC is to be abolished remains properly a matter of policy and legislation for the Australian Government and the Parliament to determine. Until that time, the responsible Ministers and the Australian Government have given repeated assurances that those who have contracts with the CEFC can have confidence their contracts will be honoured, and the CEFC has put in place arrangements to ensure that its contracted investments can continue to be funded.

For example, in the Explanatory Memorandum to the Bill, the Australian Government has stated *"in assuming the assets and liabilities of the CEFC, the Commonwealth will establish appropriate arrangements so that the requisite resources and governance to effectively and efficiently manage those investments are in place."*

In the event the abolition legislation proceeds, the CEFC is staffed by professionals who will work professionally with the Australian Government in an orderly manner to ensure a smooth transition as the Corporation's activities are wound down.

282. Yes. Please refer to the issue of the *Clean Energy Finance Corporation Investment Mandate Direction 2015* ('2015 Investment Mandate') and related materials on the Comlaw website at: http://www.comlaw.gov.au/Details/F2015L00264 and the Chair's response to issue of the 2015 Investment Mandate at: http://www.cleanenergyfinancecorp.com.au/media/107304/cefc_chairs_response_to_treasurer_and_minister_for_finance_re_2015_cefc_investment_mandate.pdf)

283-284. Under the *Clean Energy Finance Corporation Act 2012*, the CEFC Special Account maintained by the Treasury receives $10 billion in available funding over 5 years ($2 billion per annum) from the Government.

In the event that legislation passed both Houses abolishing the CEFC prior to 30 June 2015, legislated appropriations to the CEFC Special Account totalling $6 Billion would not take place.

The CEFC sits within the General Government Sector, meaning all of its transactions happen on the Government's balance sheet. While these transactions primarily affect the composition of financial assets, they also have an impact on the underlying and fiscal balance.

Treasury estimated the impact on the underlying cash balance of passing the Clean Energy Finance Corporation (Abolition) Bill 2014 (at the time of the Bill's introduction) as negative $348.5 million over the forward estimates through to 30 June 2018. The overall impact on the underlying cash balance is negative, reflecting that no further CEFC investments will be made and therefore future interest inflows and fee income over the forward estimates will be lower.

This estimate does not include costs associated with shutting down the CEFC including employee redundancy and contract termination costs which would add to this estimate. This estimate also does not include lower public debt interest costs from ceasing further Government contributions to the CEFC, which would reduce this estimate.

The abolition of the CEFC was part of the package of measures to repeal the carbon tax in the 2013-14 Mid-Year Economic and Fiscal Outlook (MYEFO) and therefore this impact is included in the current budget estimates.

285. The CEFC was established to facilitate increased flows of finance into the clean energy sector to reduce Australia's emissions of greenhouse gases.

The CEFC's investment objectives are to catalyse and leverage an increased flow of funds for commercialisation and deployment of Australian based renewable energy, energy efficiency and low emissions technology. The CEFC's legislation provides that over 50 per cent of its portfolio consist of renewable energy investments by 1 July 2018.

By financing projects the CEFC exposes the government balance sheet to risk. Under the 2013 Investment Mandate, the CEFC was charged with having an acceptable but not excessive level of risk relative to the sector.

Until such time as the Corporation is abolished, the Australian Government has taken steps to limit this risk exposure by specifying new requirements in relation to risk through the 2015 Investment Mandate. In accordance with the 2015 Investment Mandate, the Corporation is expected to apply commercial rigour when making its investment decisions, focussing on projects and technologies at the later stages of development. By adopting a commercial approach, it is expected that the Corporation will invest responsibly and manage risk so it is financially self-sufficient and achieves a benchmark rate of return. In targeting the Portfolio Benchmark Return, the overall level of risk of the Corporation's portfolio must not increase above the level of the existing investment portfolio as assessed on the date of effect of the 2015 Investment Mandate.

The Government is committed to the maintenance of the Renewable Energy Target scheme (RET), subject to amendments. The RET was designed to ensure that 20 per cent of Australia's electricity comes from renewable sources by 2020. The RET is helping to transform Australia's electricity generation mix to cleaner and more diverse sources and supporting growth and employment in the renewable energy sector.

The Government is currently negotiating with the Opposition over amendments to the RET.

The Government's positon is that the large scale renewable energy target will be adjusted from 41,000 GwH to 32,000 GwH and that the small scale renewable energy scheme be maintained. Based on current expectations of future electricity demand, this would lead to renewables representing more than 20 per cent of Australia's electricity generation mix in 2020.

The Government has committed $2.55 billion over the forward estimates to establish the Emissions Reduction Fund. The Emissions Reduction Fund will operate alongside existing programmes that are already working to reduce Australia's emissions growth such as the RET and energy efficiency standards on appliances, equipment and buildings. The Emissions Reduction Fund will provide incentives for emissions reduction activities across the Australian economy. The first auction for the ERF is scheduled for April 2015.

On 16 January 2014 the Assistant Minister for Infrastructure and Development released the Terms of Reference for a review of the Motor Vehicle Standards Act 989 (http://www.minister.infrastructure.gov.au/jb/releases/2014/January/jb003_2014.aspx). The review will identify options to reduce the regulatory burden on business and improve the safety, environmental and anti-theft provisions of the legislation.

The Government will continue to improve productivity of appliances sold in Australia though the Greenhouse and Energy Minimum Standards Act 2012 (http://www.energyrating.gov.au/for-industry/consultations/consultation-the-gems-review/) which is being reviewed with the aim of finding implementation improvements.

286. One of the fundamental principles of the ERF is payment on delivery of carbon abatement. The ERF is not intended to address the ‘upfront access to capital’ issue that is often a barrier for business looking to implement emissions reduction projects. Therefore the CEFC can play a complementary role to the ERF by providing the upfront capital that will be required should projects successfully bid in to the ERF and therefore commit to delivering abatement.

The CEFC could enhance the effectiveness of the ERF in three main ways:

1. Widening the scope and participation of ERF eligible projects
2. Helping ensure that the successful ERF projects achieve their targeted emissions reductions
3. Helping the program leave the economy better equipped to pursue cost-effective emissions reductions beyond the financial capacity and life of the ERF.

On the first point, the CEFC offers the capacity to widen the scope and participation of ERF eligible projects by securing the finance for viable projects to be considered under the ERF. The CEFC has established relationships with proven, experienced partners in the market with strong delivery capability, a developed pipeline of projects and a willingness and capacity to innovate. The CEFC has the capacity to include small and medium enterprises (SMEs) in this abatement effort through aggregation of smaller scale, but highly cost-effective projects, utilising co-financing models similar to those the CEFC has already established.

Many low cost abatement opportunities are smaller scale and disaggregated, like building upgrades and energy efficiency upgrades for business. SMEs are the least able to take the risk of investing the up-front capital associated with these projects before going to competitive auction. For these opportunities, to meet the minimum volume requirement to bid into the ERF, and to justify the cost of participating (technical, legal and professional input and advice, energy and emissions audit costs etc) will require the bundling together of a number of activities in a single bid. The CEFC’s existing aggregation vehicles in partnership with the private sector are addressing these barriers and its extensive pipeline could provide a valuable source of cost effective abatement opportunities.

On the second point, financial backing by the CEFC and co-financiers improves the likelihood of projects being completed and achieving their intended emissions reduction outcomes.

On the third point, take-up and adoption of a broad range of technologies is critical to equipping Australia with the capacity to pursue cost effective emissions reductions beyond the financing resources and life of the ERF. The CEFC's ability to provide long term financing could help improve the scope and range of projects available to the ERF.

287. Under its legislation, the purpose of the CEFC is to facilitate increased flows of finance into the clean energy sector. Under the CEFC Act and Investment Mandate, the CEFC is to apply commercial rigour when making investment decisions, target a benchmark rate of return, and operate with a commercial approach. As such, the CEFC investment model represents a very low cost to government of emissions abatement.

The CEFC has committed investment of some 10 per cent of the CEFC's total $10 billion in appropriations available under the CEFC Act. The CEFC's committed investments to date include projects that, once constructed and operational, are estimated to achieve annual abatement of approximately 4.2 million tonnes CO2e p.a.

It is important to note that the CEFC does not claim that the projects it invests in will bring about abatement in isolation of other government policies, or general economic parameters (e.g. the RET, the former carbon price, or various state government incentives). Because the CEFC works applying commercial rigour, its participation as an investor in projects is as a complementary mechanism to those policies to help deliver abatement.

Any projection of the amount of abatement that CEFC funded projects might ultimately involve would require forecasting a range of variables, including the portfolio mix and the multiple of private sector funding which is leveraged into those projects (e.g. between large scale project finance and financing programs for smaller scale SME energy efficiency investments; the variable capital intensity of carbon savings across different sectors and types of projects and technologies).

The CEFC has placed on the record the impact of the ongoing uncertainty around the CEFC's own future, and of the presently subdued demand for renewable energy investment and energy market investment generally, based on the market and policy factors referred to in the answer to Question AET276. All of these factors impact the carbon abatement that projects in which the CEFC is involved would be able to realise were its total $10 billion availability be invested. As such, a reliable further estimate would not be feasible until market conditions are more certain.