Clean Energy Finance Corporation Statutory Review

Submission

Rod Campbell

February 2018

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Level 1 Endeavour House, 1 Franklin St
Manuka, ACT 2603
Tel: (02) 61300530
Email: mail@tai.org.au
Website: www.tai.org.au

INTRODUCTION

The Australia Institute welcomes the opportunity to make a submission to the Department of the Environment and Energy as part of the Clean Energy Finance Corporation Statutory Review.

This submission makes five main points regarding the CEFC relating to the two key issues for consideration by the Department, being: the effectiveness of the CEFC in facilitating increased flows of finance into the clean energy sector; and any other matters considered relevant to the operation of the CEFC Act more generally:

1. The CEFC has made a positive contribution to the market.
2. Policy makers should consider increasing the CEFC Special Account to $30 billion
3. The return hurdle should be returned to the original expectation of cost recovery, rather than the cost of funding plus 3-4%
4. The CEFC should consider using a greater amount of concessionality to support innovative and emerging technologies and renewable energy zones
5. Governments should not, through the investment mandate, be able to allocate the portfolio to particular programs.

CEFC'S POSITIVE CONTRIBUTION TO THE MARKET

The CEFC has made, and should continue to make, a positive contribution to Australia's clean energy market. In the long run, the CEFC can be an important institution in Australia's decarbonisation transition, which is only in its early stages. The provision of debt or equity to businesses and programs represents an attractive policy tool with the potential to crowd-in other sources of public and private sector finance while maintaining budget neutrality and developing important skills and experience in the rapidly growing clean energy sector. In fact, the CEFC, has the dual benefit of supporting a public policy objective of decarbonising the economy while potentially earning tax payers a profit. Since Macquarie Bank's acquisition of the UK Green Investment Bank, the CEFC is, by a long margin, the world's largest government owned investment institution with a focused clean energy mandate. This unique position in the Australian and global energy transition provides Australia with a strategic competitive advantage in the clean energy sector.

Since 2012, the clean energy market in Australia, and renewable energy in particular, has faced ongoing and at times significant uncertainty. Large-scale renewable energy and infrastructure finance is by nature lumpy, an attribute compounded by this ongoing policy uncertainty. The CEFC has acted as a stable presence in the market over this time, helping to catalyse projects with a total value of some $16 billion.[1] The CEFC can also play an important countercyclical role, such as during 2014-15, when the only large-scale renewable energy projects announced were those able to secure the support of the CEFC or the Australian Renewable Energy Agency (ARENA), or to participate in the ACT's tender process.[2]

Outside of renewable energy, the CEFC has also provided finance to projects, businesses and programs that demonstrate the potential for clean energy deployment and emissions reductions across the broader economy. Examples include the CEFC's energy efficiency finance programs with banks and vehicle financiers[3] and investments into green buildings,[4] including community housing,[5] and infrastructure.[6]

More broadly, the CEFC has also supported greater capital market liquidity for clean energy through its support for, and investments in, green bond issuances in Australia.[7]

Given its unique position in the market, the CEFC can play a valuable role in policy design and debate. Its submissions to various inquiries suggest that there is significant broader public interest in the perspective the CEFC can offer to policy makers, stakeholders and the public.[8] This role should be maintained and encouraged as the CEFC is one of few government bodies with a private sector-focused mandate and staffing that is focused on achieving policy objectives.

The CEFC's public reporting is of a high standard and its key metrics, being the performance criteria set out in the Corporate Plans and Portfolio Budget Statement, are adequate to assess the CEFC's effectiveness in meeting its objectives. Additional transparency on the status of the current portfolio in terms of total commitments since beginning operations, current investments and current deployment amounts would, however, provide additional useful information for stakeholders. This could be provided at an individual deal level and also at a useful level of aggregation based on finance type, sector and technology. This information is reported in annual reports, but there could be more accessible ways for stakeholders to access this data online.

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[1] CEFC (2018) *Statutory review of the Clean Energy Finance Corporation: CEFC submission,* https://www.cefc.com.au/media/390711/statutory-review-cefc-submission-february-2018.pdf

[2] CEFC (2015) *Annual report 2014-15,* http://annualreport2015.cleanenergyfinancecorp.com.au/media/1100/cefc-annual_report_2014-15.pdf

[3] CEFC (n.d.) *Asset finance,* https://www.cefc.com.au/where-we-invest/asset-finance.aspx

[4] CEFC (n.d.) *Property,* https://www.cefc.com.au/where-we-invest/property.aspx

[5] CEFC (n.d.) *Community housing,* https://www.cefc.com.au/where-we-invest/community-housing.aspx

[6] CEFC (n.d.) *Infrastructure,* https://www.cefc.com.au/where-we-invest/infrastructure.aspx

[7] CEFC (n.d.) *Climate bonds,* https://www.cefc.com.au/where-we-invest/climate-bonds.aspx

[8] CEFC (n.d.) *Submissions,* https://www.cefc.com.au/publications/submissions.aspx

Despite the strong performance of the CEFC, it was never anticipated to operate in isolation of other policies to support a clean energy transition. Accompanying policies to support renewable energy, energy efficiency and low-carbon technologies are needed across all sectors and all levels of government. This needs to include a credible long-term policy to induce new renewable energy capacity into the market, especially when incumbent generators are highly polluting and old, and with very low operating costs. As part of this, the Australian Renewable Energy Agency should have its budget increased and be encouraged to continue to consider programmatic approaches alongside the CEFC, such as those that helped to catalyse large-scale solar PV or the Clean Energy Innovation Fund.

CONSIDER INCREASING THE CEFC SPECIAL ACCOUNT TO $30 BILLION

Australia's decarbonisation transition is only just getting started. To transition Australia to a competitive net zero economy in the next thirty years will require significant amounts of capital and consistent policy support. Without policy certainty and support, renewable energy investment is unlikely to meet the trajectory required to reach 66-75 per cent by 2030 – the approximate level of renewables that most science-based targets suggest is required for Australia's Paris commitments.[9] Energy efficiency in Australia arguably lags far behind what would be possible if stricter vehicle emissions and building or appliance standards were applied.

At a global level, while progress on wind and solar has been positive,[10] many other clean energy opportunities remain below the level they need to reach to be consistent with a 2-degree trajectory. And even for solar and wind, while economics and deployment in isolation have been promising, additional efforts and investment will be required to integrate higher levels of variable renewables into the National Electricity Market, particularly as rooftop solar and home energy storage usage grows.

In the long run, unlocking new renewable energy sources or regions across Australia will require significant investment, often without precedent for the current generation of policy makers and investors. The CEFC could play a strong role in unlocking such

[9] Campbell (2017) *Meeting our Paris Commitment,* http://www.tai.org.au/sites/defualt/files/P439%20Meeting%20our%20Paris%20Commitment%20-%20TAI%20Climate%20and%20Energy%20Program%20-%20September%202017.pdf

[10] IEA (2017) *Tracking clean energy progress 2017,* https://www.iea.org/publications/freepublications/publication/TrackingCleanEnergyProgress2017.pdf

regions, helping to attractive private sector co-investment. For example, The Australian Energy Market Operator's Integrated System Plan[11] could potentially require significant investment, which the CEFC could help support. The CEFC has itself, through the consultants Jacobs, pointed out the potential for transmission upgrades to facilitate higher levels of renewables.[12]

As a result of the factors above, we believe that the CEFC's role is just beginning. The CEFC's most recent annual report suggests that the Corporation has current commitments of around $3.5 billion.[13] This amounts to approximately 35 per cent of the $10 billion available to the CEFC through its special account. As the CEFC's investment activities grow, it is likely that the Corporation will hit capital constraints which will affect its ability to make new investments, particularly given the importance of building a balanced portfolio.

With significant further investment required to meet net zero emission targets, we recommend that consideration be given to increasing the CEFC's special account to at least $30 billion. As the size of the CEFC portfolio grows, the federal government could even consider issuing a green bond to fund the expansion of the CEFC special account. As long as the CEFC makes all investments at a rate above the government cost of funding this Green Bond, and covers operating costs and expected losses, the CEFC would be revenue neutral, while providing significant broader economic benefits. In the longer run, consideration could also be given to a broadening of the CEFC's mandate to include non-energy sector emissions reductions opportunities.

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[11] AEMO (n.d.) *Integrated system plan,* https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Planning-and-forecasting/Integrated-System-Plan

[12] Jacobs (2016) *Benefits of transmission upgrades in a transforming electricity sector,* https://www.cefc.com.au/media/222968/benefits-of-transmission-upgrades-in-a-transforming-electricity-sector.pdf

[13] CEFC (2017) *Annual report 2016-17,* http://annualreport2017.cefc.com.au/media/1399/cefc-annual-report-2017.pdf

RETURN HURDLE SHOULD BE CHANGED BACK TO COST RECOVERY

The CEFC Expert Review Panel recommended that the target rate of return for the CEFC should:

> be a nominal return on investment assessed over the entire portfolio across time, including an allowance for losses and operating expenses…The Panel considers that the Government borrowing rate is an appropriate target.[14]

This recommendation was adopted in the first Investment Mandate the then government issued to the CEFC, which stated:[15]

> The Board is to adopt a benchmark for the return of the portfolio based on a weighted average of the five-year Australian Government bond rate. Performance against this benchmark will be measured net of operating expenses.

Disappointingly, later governments first increased the benchmark return to 4-5% above the five-year bond rate,[16] before lowering it to 3-4%.[17]

The Australia Institute believes that the return hurdle should be returned to the original recommendation of the Expert Panel, and the original Investment Mandate to cover the government cost of funds, net of operating expenses and inclusive of expected losses. Unlike the Future Fund, the CEFC is not expected to provide for future liabilities. The CEFC's primary role, as per the Act is to "facilitate" increased flows of finance into clean energy, not to make a quasi-private sector return from any investments.

Setting a higher return target potentially encourages the CEFC to take higher risks or to pursue more commercial deals at the expense of opportunities with greater impact from a public policy perspective. Importantly, we believe that the primary purpose of the CEFC should be consistent with facilitating the increased flows of finance into the

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[14] Commonwealth of Australia (2012) *The Clean Energy Finance Corporation, Report of the Expert Review Panel,* p 19

[15] *Clean Energy Finance Corporation Investment Mandate Direction 2013,* https://www.legislation.gov.au/Details/F2013L00680

[16] *Clean Energy Finance Corporation Investment Mandate Direction 2015,* https://www.legislation.gov.au/Details/F2015L00264

[17] *Clean Energy Finance Corporation Investment Mandate Direction 2016,* https://www.legislation.gov.au/Details/F2016L00714

clean energy sector. Overemphasis on returns places different expectations on the Board and Staff.

CONSIDER INCREASING CONCESSIONALITY TO SUPPORT INNOVATIVE AND EMERGING TECHNOLOGIES AND RENEWABLE ENERGY ZONES

Under the CEFC's Investment Mandate, it is permitted to provide up to $300 million of concessionality in any given year.[18] Despite this, the CEFC has shown a reluctance to utilise concessional finance. The CEFC's 2016-17 annual report suggests that just $6.9 million of concessionallity was used in 2016 and $11.4 million in 2017.

On the one hand this is a good sign of the CEFC's commercial approach to investing. On the other hand, it is possible that the CEFC's impact could be greater if it were willing to use more concessionality, especially for emerging and innovative technologies where proof of demonstration can be critical to scaling up usage.

One reason why the CEFC may be reluctant to use its concessional financing ability, apart from commercial reasons could be that this would potentially impact book profitability. As note 2.1C of the 2016-17 annual report states:[19]

> The Group is required to record a non-cash concessional loan charge when it makes a loan at a discount to the prevailing market equivalent rates or terms.

In other words, if the CEFC used too much concessionality, the non-cash concessional loan charges could result in an accounting loss, which could be used politically to suggest the CEFC is costing tax payers money. In reality, as long as the CEFC covers the costs of funding over the life of any investments, expected losses and its operating costs, it will have a neutral or better budgetary impact.

The CEFC could also explain its use, or otherwise, of concessional finance in its annual reporting, providing reasons why concessional financing has, or has not been, used and identifying sectors or opportunities where potential exists for concessional financing.

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[18] *Clean Energy Finance Corporation Investment Mandate Direction 2016 (No. 2),* https://www.legislation.gov.au/Details/F2017L00035

[19] CEFC (2017) *Annual report 2016-17,* http://annualreport2017.cefc.com.au/media/1399/cefc-annual-report-2017.pdf

GOVERNMENTS SHOULD NOT ALLOCATE THE PORTFOLIO TO PARTICULAR PROGRAMS

Under the Clean Energy Finance Corporation Act 2012,[20] the Responsible ministers for the CEFC may issue an Investment Mandate giving certain direction to the Board regarding the activities of the Corporation.

We are supportive of using the Investment Mandate to provide broad direction to the CEFC regarding its focus areas. For example, the broad direction to the CEFC to focus on emerging and innovative technologies, as per Clean Energy Finance Corporation Investment Mandate Direction 2015 (No. 2),[21] was useful to set expectations concerning potentially higher risk investments. Similarly, we believe that giving direction to the CEFC to expand efforts to unlock new renewable energy zones and transmission investments could be beneficial. We do not, however, support the setting of explicit targets for the portfolio, as we believe this is potentially overreach, effectively directing the Board to make particular investments and potentially making it difficult to build a balanced portfolio.

In recent years the Investment Mandate has at times been used in overly prescriptive and political ways, particularly with regard to the "Sustainable Cities Investment Program" and the "Reef Funding Program".[22] These directions have a combined result of earmarking up to $2 billion of the CEFC's $10 billion special account, and in doing so, make it more difficult for the Corporation to pursue and respond to market opportunities and build a risk adjusted portfolio. Had the Clean Energy Innovation Fund not been re-sized from $1 billion to $200 million between Clean Energy Finance Corporation Investment Mandate Direction 2016[23] and Clean Energy Finance Corporation Investment Mandate Direction 2016 (No.2)[22], the total amount of funds earmarked in the Investment Mandate would have been $3 billion.

Specifically, in the case of the Reef Funding Program, the CEFC was used as political 'covering fire' for the government at the time due to significant public concern about the state of the Great Barrier Reef. As climate change is the single biggest long-term threat to the Great Barrier Reef ("GBR"), the CEFC is arguably already contributing.

[20] *Clean Energy Finance Corporation Act 2012,* https://www.legislation.gov.au/Details/C2017C00265

[21] *Clean Energy Finance Corporation Investment Mandate Direction 2015 (No. 2),* https://www.legislation.gov.au/Details/F2015L02114

[22] *Clean Energy Finance Corporation Investment Mandate Direction 2016 (No. 2),* https://www.legislation.gov.au/Details/F2017L00035

[23] *Clean Energy Finance Corporation Investment Mandate Direction 2016,* https://www.legislation.gov.au/Details/F2016L00714

We believe that the broad requirement in the Act for the CEFC to invest up to 50% of its portfolio into renewable energy is a sufficient direction and that governments should refrain from allocating a portion of the special reserve account to support short-term political objectives. If, however, allocations are in-line with projected long-term and science-based scenarios for energy sector decarbonisation, then they could be useful. In such cases, such directions should be made alongside additional funding for the special account, so as to not dilute the CEFC's activities in other sectors.

CONCLUSION

Overall, the CEFC is making a valuable contribution to Australia's energy sector and to our emissions reduction targets. There is potential to increase its effectiveness and expand its operations. We would be happy to expand on this submission to the review panel.