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Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

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Dear Sir / Madam,

The Investor Group on Climate Change ("IGCC") represents Australian institutional investors (including superannuation funds and investment managers) who participate in a broad range of investment strategies[1], with funds under management of around $700 billion, and other key participants in the investment community. We are managers of retirement savings and investments and are concerned with the long-term impacts of climate change on the stability of the economy. We invest in all sectors of the economy, emissions-intensive and low-emission alike, and are part owners of many Australian companies.

The challenges of transitioning to a low carbon economy require an unprecedented level of capital investment far beyond public sector capabilities. Traditional private sector sources of capital have been the balance sheets of energy utilities or capital sourced from independent project developers and supported by local commercial banks. However the capital requirements for renewable energy projects alone to 2030 will be in excess of $100bn in Australia and will certainly require institutional investor support.

Compounding this challenge are the current sovereign debt issues and Basel III capital adequacy constraints on banks, which are leading to reduced ability to provide large volumes of debt capital and shorter duration lending.

IGCC believes that an independent financing institution is an important supporting measure to a carbon price to stimulate the transition to a low carbon economy. There is a critical role for an enduring institution to play in leveraging public sector capital to encourage private sector investment in areas where private sector capital is needed to fund the transition to a low carbon economy. It is in this context we welcome the establishment of the Clean Energy Finance Corporation (CEFC) to give further impetus to renewable energy and clean technology investing in Australia.

Addressing barriers to investment

IGCC notes that a number of financial and other barriers exist to the deployment of capital to low carbon investments, irrespective of investor confidence in the likely trajectory of emissions reductions over the next 20 years. The CEFC can address financial barriers related to both the availability and cost of finance, including constraints due to:

[1] Including listed equities, debt/fixed interest, infrastructure, private equity, venture capital and property.

- Lingering impacts of the global financial crisis;
- Constraints on the availability of debt capital, heightened by the withdrawal of many foreign banks from the Australian market;
- Commercial banks facing ‘look through’ or aggregation exposure to some counterparties to power purchase agreements with renewable power generators;
- A general lack of demand within commercial banks for clean energy projects that have resource risks (e.g. wind) or have technology risks (e.g. concentrated solar);
- Scale constraints where many projects may be too small or too large to secure funding on suitable terms;
- Forecast return outcomes on investment projects which are not considered by equity and debt investors to provide adequate compensation for the risks inherent in these projects.

The CEFC can also address non-financial barriers that are constraining the development of low-carbon industry in Australia, including:

- imperfect information, based on short track record of investment performance in the clean energy sector;
- technology risks;
- grid constraints and challenges associated with deploying new transmission lines, particularly across state borders and to remote areas;
- a lack of availability of long term Power Purchase Agreements which reflect the duration of a renewable power generation asset’s useful life and the potential for long-term financing (more appropriate matching of tenors is critical for encouraging renewable energy infrastructure projects given the high up-front capital costs and long useful lives (e.g. 25 years) relative to length of revenue certainty (which may be as little as 5-10 years) which may not be sufficient to attract debt or equity capital at a suitable cost);
- capital intensity and payback period both present challenges: it takes far more capital to pay for relatively larger demonstration projects and the time to achieve significant revenue;
- scale is also an issue for private equity investors, which often have difficulty supporting the transaction and management costs of projects smaller than $20-50M. Scale coupled with a lack of a well recognized investment model have been the critical issues in impeding small (commercial) renewable energy and waste to energy projects;
- there is a lack of experience within many investment managers on clean energy and clean technology investment opportunities, which has resulted in short performance track records of managers in the clean energy sector; and
- the potential for new disruptive technologies to undermine investments undertaken based on existing technologies.

While not all CEFC investments will address all constraints, there is an opportunity for the CEFC to utilise its investment capital to reduce these financial and non-financial barriers and make private sector investment more attractive, thereby stimulating additional private sector investment into clean and renewable energy projects and businesses.

Key principles for operation of the CEFC

Key principles regarding the operation of the CEFC appear to have been recognised in the enabling legislation for the CEFC. Given their importance to the investment community, they are restated here.

Independence from Government

For the investment community to be confident in the operation of the CEFC, it is essential that the CEFC Board retain responsibility for directing the investments of the organisation, without undue influence from Government. Investors will assess investment opportunities on their commercial merits. We consider that the freedom for the CEFC to examine clean energy related investment opportunities within high-level clean energy themes will allow the flexibility necessary for the CEFC to encourage private investors to propose and co-sponsor investment opportunities. If Government becomes closely involved in directing investment parameters, and these parameters are seen to be open to change based on short term political priorities, the effectiveness of the CEFC in deploying finance and leveraging private sector finance may be constrained.

Operate in a commercial manner

The investment discipline required to deliver a financial return to the Commonwealth should demand a rigorous investment process for the CEFC. For private investors this has a number of benefits over government based co-financing structures.

First, having a co-investment counterparty that follows commercial processes should improve the efficiency with which investment decisions are proposed and assessed. This will encourage private investors to seek to partner with the CEFC. When public co-financing is deployed directly by governments, transaction costs usually increase for private parties and act as a disincentive to investment.

Secondly, by investing for a financial return and having the capacity to re-invest capital, there is the opportunity to establish an enduring institution that can play an important role in supporting a significant reallocation of capital towards low carbon infrastructure and businesses over time. This should encourage private investors to build capacity in their own organisations, even as the level of ambition in international responses to climate change continue to develop.

Thirdly, we note that the expectation of a financial return limits the impact of the CEFC on the Federal Budget which should present a compelling reason for Parliamentary support for such a co-financing institution in future.

Other matters – a clear financing path

We note recent public discussion about the relationship of the CEFC to the carbon price and renewable energy target. While freeing up financing for projects that contribute to a short term (2020) renewable energy target will be one consequence of CEFC operation, IGCC considers that one of the main benefits of the institution is to provide a clear funding path for technologies and renewable energy that will be deployed at scale after 2020. One of the major constraints to development of new technologies in Australia is the lack of a clear path for follow on financing of locally developed technologies and ventures. It is our view that the continuity provided by government R&D incentives, venture financing arrangements, ARENA and then the CEFC, provide a funding path for local ventures that has not to date been available for local business or co-investors. The benefit of a clear public financing path is that it should encourage additional private investment in a range of renewable and low carbon activities in Australia, providing more options for future emissions reductions, and energy generation in Australia.

Conclusion

Considering the significant scale of investment required to substantially reduce emissions in Australia, the IGCC believes there is a clear role for an enduring finance institution that addresses barriers to low carbon investment. A clear investment mandate and boundaries for the operation of the CEFC are critical for building private sector investor confidence in the transparency, certainty and longevity pf the low carbon financing framework in Australia, and the IGCC believes that the proposed legislation for the establishment of the CEFC provides an appropriate framework for the development of the CEFC as an enduring institution focused on stimulating and supporting the transition to a low carbon economy in Australia.

Yours sincerely,

Nathan Fabian
Chief Executive
Investor Group on Climate Change