Tabled 13/2/12 by
Ms McDonald, LCA

Thank you.

- As the Committee will be aware this is Low Carbon Australia's inaugural appearance at Senate estimates and it might be opportune to give the Committee a very brief description of who we are and what we do.

- The first thing to understand is that LCAL is still a very young company. We have just 25 employees and have just passed 18months of actual program operations.

- Until 8 April 2011, Low Carbon Australia Limited was known as the Australian Carbon Trust Limited. In May 2009 the Government's announced its intent to form a Trust similar to the Carbon Trust formed by the UK Government.

- The company was formed as a *Corporations Act 2001* company on its registration with ASIC on 14 January 2010 with the company beginning operations in March of that year.

- An initial funding agreement was signed with the Department on 25 February 2010 to cover establishment costs, and in June 2010 we signed the Head Funding Deed with the Department, for a total $100m funding.

- The company commenced the Energy Efficiency and Carbon Neutral programs on 1 July 2010, and so in July 2011 we completed our first full-financial year of operations, and tabled our first annual report to Parliament in October last year.

- The Company runs two programs for the Australian Government: the Energy Efficiency Program and the Carbon Neutral Program.

- The majority of LCAL's resources and efforts are currently focused on execution of the Energy Efficiency Program (EEP) which constitutes 84% ($84.6 million) of the Company's Australian Government funding.

- The EEP is a commercially based; revolving investment fund focused on providing demonstration to the marketplace on how to overcome market failure in order to achieve significant improvements in energy efficiency and reduced carbon emissions from the non-residential building sector and in industry.

- Under the EEP, LCAL loans money for the specific purpose of energy efficiency and greenhouse gas abatement. The loan is repaid back into the fund with interest. In turn the repaid principal plus interest can be loaned to another business for a new project and so the revolving fund continues.

- It is somewhat similar to the proposed Clean Energy Finance Corporation in miniature, but is more limited in its remit - under the EEP loan funds can only be applied to the installation of commercially available technology in commercial buildings, industrial processes.

- Senators should note this is very different to grants. We do not give money away for free. We charge interest for the money we lend, and the interest rate is calculated according to the risk represented by each particular loan.

- LCAL's strategy is to offer finance at a market competitive rate with adjustment for risk-weighting, and usually on a longer fixed term than other financers in the market. LCAL is matching the repayments of finance to the energy savings. LCAL's financial modelling and assessment capability includes a detailed cost of carbon abatement methodology where energy and carbon savings are estimated over the investment life of a project and repayments are set to match the forecast savings. LCAL has the flexibility to tailor the finance being offered to suit the individual company's needs.

- Low Carbon Australia has adopted a strategy of using our limited funds to maximum effect. It would be easy to simply advertise and make one off low interest loans at a rate which undercuts the banks. That is not the approach Low Carbon Australia has adopted – we have not set out to undermine existing finance options and have instead set ourselves up with a much more difficult approach of limiting our finance to addressing the market failure that exists and helping create a market for energy efficiency finance in Australia.

- As a relatively small pilot fund, LCAL has taken the approach of co-investing in innovative financing with companies with significant customer reach. This is a more effective means of driving change in the marketplace on a wide scale, achieving private sector financial leverage to realise greater total investment, greater capacity building of the marketplace and realising greater amounts of carbon savings than LCAL could achieve investing its small fund alone. LCAL products can then be accessed by small and medium sized business through the large financial, utility or leasing companies that support them.

- At the same time LCAL's initial one-off direct loans for energy efficiency projects have been selected to provide important demonstration value of cost-effective energy and carbon savings. There is a distinct need for this in the market which is not being met at the current time. For example, mid-tier and smaller companies and organisations such as local councils have little internal capital and face constraints in raising finance to execute these projects.

- Our financial offerings have been developed after extensive market research and designed to address specific areas of market failure. To this extent we do not compete with private sector finance but work to complement it.

- Senators should also note that in addition to financial return and market-making, the criteria which have been given to us by the government for this fund, require us to mobilise private funding of at least $1 for every $1 we lend, and that the projects we fund must achieve carbon abatement through energy savings and must beat the economy-wide cost of $23/tonne.

- Additional criteria which we use for evaluation of Investment opportunities include: Demonstration effect, replicability, scalability, geographic spread, sectoral spread, project 'additionality' (that is, whether the project would have happened at the time it happened or at the scale but for LCAL involvement in the investment), and other finance leveraged etc.

- We are now two years into this five year Energy Efficiency Program. Of the total $84.6m received by Low Carbon Australia as its initial loan fund under the EEP, LCAL has contractually committed over $30m for investment, mobilising over $100m (inclusive of LCAL funding) in new private sector clean energy finance in the market.

- We still have a lot of work to do in driving uptake of our offer, but from the market point of view LCAL is welcomed as a company that works to reduce the risk around energy efficiency financing and we continue to work with a wide range of companies and finance providers to develop new financing offers which we'll be bringing to the market in coming months. .

- From a Government perspective, LCAL's EEP represents a completely different way of delivering government investment, a better way to use limited public funds and a much less market-distorting effect than grants or tax-breaks.

- If our financial structures see significant uptake and are being offered by others in the marketplace, this would signal that these market failures had been successfully overcome, further intervention wasn't needed and we would look to exit that area of the market and instead concentrate on the next horizon.

- After the two years of experience we've had in developing this program, we're confident that there is no shortage of need for this in the marketplace. Market uncertainties and economic conditions only add to that need. Despite the positive business case on paper, (energy efficiency is often referred to as "the low hanging fruit") investing in energy efficiency remains a complex area of decision-making for most businesses as it involves a large array of energy saving technologies. Key issues include:
    - <u>Term:</u> Many clean energy technologies have payback periods in excess of typical corporate funding finance terms (3 to 5 years) or internal capital allocation hurdles which require rates of return commensurate with 3 to 5 year paybacks.

   - Availability of funds: Availability of funds for energy efficiency projects are not primarily driven by the technology type but rather by the credit position of the building or industry corporation and the finance market environment.
   - There are other priorities for capital: Capital may well be available for investment but competing investment needs can displace clean technology investment as a priority.
   - Demand is susceptible to general economic conditions: companies are generally risk adverse when considering investment in new capital projects that are non-core business.
   - Complexity and internal decision making adds to time delays.
   - Transactional cost may be too high for some businesses.
   - Many organisations have difficulty identifying appropriate technology solutions and suppliers / vendors.
   - Construction requires long project lead-times which in turn requires patient capital.
   - Availability of grant funding places a dampener on demand for loan products.
   - In the public sector, stringent central Treasury rules can make borrowing arrangements difficult.
   - Immaturity of the clean technology market means there is inherent capacity constraints in terms of both skill and ability to successfully manage projects though to conclusion.

- While the current funding places limits on LCAL's flexibility in the type of energy efficiency and greenhouse gas abatement projects LCAL can finance, the financial products and the capability it has developed can be cost effectively and readily scaled-up to address the broader economy-wide energy efficiency task.
- LCAL is required by the Australian Government to undertake the EEP in a manner that promotes the financial-sustainability of the program. LCAL has incorporated this requirement into its investment guidelines and looks to achieve an appropriate financial return to LCAL when making investment and resource allocation decisions. However, at LCAL's current level of funding, full financial-sustainability cannot be realised.

- The other program LCAL runs is the Carbon Neutral program under the National Carbon Offset Standard (NCOS) which is essentially the Australian Government's replacement for the terminated Greenhouse Friendly program.

- To the Carbon Neutral Program is run on the smell of an oily rag at cost recovery and funded at $200,000 per year. Companies pay to achieve the Australian Government accreditation of carbon neutrality under the program which is provided by LCAL.

- Senators should note that LCAL is only the administrator of this program and in particular does not make any decisions around what offsets are recognised under the program, the content of the Standard, policy decisions about the Standard or the design or use of the NCOS mark.

- In order to assist the Committee's inquiries, I am also happy to table a list of consultants that regularly feature in Senator's questions on notice that we have not ever engaged and that are not under consideration of engagement at the present time, congruent with previous advice that we have given:

Consultants that Low Carbon Australia has not engaged and is not considering engaging as at 13 October 2013	
Hawker Britton	McKinsey & Company
John Utting & UMR Research Group	
Shannon's Way	
McCann-Erickson	
Cutting Edge	
Ikon Communications	
CMAX Communications	
Boston Consulting Group	

- Finally, to assist the Committee's inquiries, Low Carbon Australia is not subject to the efficiency dividend because it is not an agency covered by the *Financial Management and Accountability Act 1997*. The efficiency dividend does not apply to Commonwealth companies. Therefore, so long as this is the case, regardless of what the level the efficiency dividend is set at the number of staff it will affect at LCAL is zero.