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Putting investors in the picture on climate change

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For discussion

- What does the carbon price mean for investment markets?
- Why is there a need for other policy measures?
  - What should the try to achieve?

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CEFC

- Market Failures – Renewable Energy
- Clean Energy Finance Corporation
  - Objectives
  - Structure
  - Strategy
  - Products
  - Considerations

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Market Failures – Renewable Energy

- Policy and regulatory risks & uncertainty
- Scale of opportunities & attractiveness to institutional investors
- Imperfect information – lack of precedent and track record of performance in renewable sector; technology risks
- Market power of vertically integrated gentailers – debt providers require significant power price hedging through PPAs ; limited creditworthy parties which limits new entrants
- Grid constraints – interstate interconnectors and new transmission lines to remote locations are a financing challenge
- Risk adjusted returns – renewables do not offer as attractive risk adjusted returns as other infrastructure assets such as regulated, economic or availability based PPPs

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CEFC – objectives

- Focus on deploying financial solutions that catalyses the supply of private sector capital
- Tailored and targeted investment products
- Build upon existing financial markets and expertise
- Aim to generate positive portfolio returns and increase its capital base
- May tolerate negative returns in limited scenarios (versus grants)
- Avoid investment where non-additional (i.e. where investment can be met by private sector alone)
- Avoid crowding out or competing with private sector capital

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CEFC - Structure

- Needs to be independent and arms length from Government – build market confidence and credibility
- Board and Executive needs strong banking and finance expertise
- Similar structure to LCAL – public company limited by guarantee

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CEFC – investment strategy

- Maximum single investment exposure limits to be established
- Appropriate aggregate exposure limits to technologies, investment stages, sectors, individual projects/companies etc
- Additionality test – CEFC capital needed for viability
- Financial return hurdles can be concessional but minimise distortion of market
- Returns should ensure capital preservation and accumulation
- Environmental investment metrics to be established
- Recycling of capital – permitted but within constraints
- Minimal overlap with other government bodies and programs

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CEFC – investment products

- Investments across capital structure
  - Equity (ordinary, preferred)
  - Debt (mezzanine)
  - Hybrid/structured financings
- Investments directly into assets or through fund structures
- Risk management/mitigation products
  - PPA derivatives (insurance products to underwrite power price volatility)
  - Refinancing guarantees post-construction
  - Loan guarantees (repayment of principal and interest by borrowers)
- Advice to government in relevant policy areas

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CEFC – considerations

- Pace of establishment of CEFC – LCAL took 2 years to setup
- Relationship between CEFC and other bodies & programs
  - Low Carbon Australia ("LCAL")
  - ARENA
  - MRET Scheme
  - Solar Flagships program
- Clear mandate and boundaries are crucial for building investor confidence in transparency, longevity and certainty of low carbon financing framework

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