CASE STUDY: ANNEX J

AUSTRALIA - CLEAN ENERGY FINANCE CORPORATION (CEFC)

Background and Establishment

The CEFC is an Australian Government-owned institution (or “green bank”) that was established in August 2012 to facilitate increased flows of finance into the clean energy sector and to support the government’s commitments to reduce carbon emissions. Using government funding, it invests in and supports clean energy projects, although across its portfolio it must deliver a positive return for taxpayers. It also supports innovative start-up companies through a dedicated Innovation Fund.

Establishing the CEFC was a controversial policy, and a subsequent government sought to abolish it on the basis that this form of government intervention was not necessary. In particular, there was some opposition to the CEFC’s proposed role in supporting onshore wind and domestic solar photovoltaic project, because these were more established technologies. Notwithstanding this opposition, the CEFC remains in operation today.

Mandate

The CEFC mandate was established in the Clean Energy Finance Corporation Act 2012 and the prevailing Investment Mandate, which can be amended by the government from time to time[1].

The Mandate stipulates that the CEFC is a mechanism to help mobilise investment in renewable energy, low-emissions and energy efficiency projects and technologies in Australia, and to help finance Australia’s clean energy sector using financial products and structures to address the barriers inhibiting investment. The CEFC should make commercial investment decisions, though it can offer concessional finance terms. For example, it should have regard to positive externalities and public policy outcomes when making investment decisions.

The Mandate also stipulates that the CEFC must target an average return of the five-year Australian Government bond rate of three to four percent per annum over the medium- to long-term, whilst seeking to develop a portfolio of projects from across the spectrum of clean energy technologies that in aggregate has an acceptable but not excessive level of risk.

The Mandate also places the following limits on the CEFC’s activities:

- The CEFC must limit the amount of concessionality it provides in any one financial year to AUD 300 million (USD 213 million). Concessionality reflects the mark-to-market valuation of loans made that financial year and is measured as the difference between the present value of each loan at market rates and the present value of each loan at the given concessional rate.
- The CEFC should seek to avoid the use of guarantees where possible. It must ensure that all guarantees are limited and quantifiable, and at no time may the total potential liability of outstanding guarantees exceed the amount of uncommitted funds available to the CEFC.
- In undertaking its investment activities, the CEFC must consider the potential effect on other market participants and the efficient operation of the Australian financial and energy markets.
- The CEFC must focus on supporting emerging and innovative renewable energy technologies and energy efficiency technologies, such as large scale solar, storage associated with large- and small-scale solar, offshore wind technologies and energy efficiency technologies for the built environment.

The Mandate also includes various other directions in relation to specific funds managed by the CEFC that have focused themes (e.g. the Clean Energy Innovation Fund, the Sustainable Cities Investment Program and the Reef Funding Program).

The government can provide direction to the CEFC through the Investment Mandate, providing the direction:

- does not require the corporation to make or not make a particular investment; and
- is not inconsistent with the CEFC Act.

1 The current version of the mandate is available online here: https://www.legislation.gov.au/Details/F2017L00035

Institutional Structure

The CEFC is a corporate Commonwealth entity – a body that has a separate legal personality from the Commonwealth, and can act in its own right, exercising certain legal rights such as entering into contracts and owning property.

Under the CEFC Act, the CEFC has two responsible Ministers: the Minister for the Environment and Energy, and the Minister for Finance, through which the CEFC Board is accountable is accountable to Parliament.

The CEFC Act provides for a governing Board. The Board acts independently of the Australian Government, although all Board members are government-approved appointees. In turn, the Board appoints the Chief Executive Officer (a statutory officer) and Executive staff, who are employed under such terms and conditions as the Board sees fit.

Governance Structure

The CEFC Act provides the Board with statutory responsibility for decision-making, performance of the CEFC's functions, and making and managing investments. The Board can, as required, delegate authority to individual Board members to work with the Executive Team on investment decision-making or risk management matters. The Executive Team is responsible for implementing the Board's decisions, conducting portfolio reviews and managing day-to-day investment matters.

While the Board retains responsibility for investment decisions and portfolio management, the Audit and Risk Committee oversees the audit, risk, compliance and assurance functions, reviews financial statements and evaluates the adequacy and effectiveness of the risk management framework.

The Executive Investment Committee assesses investment proposals. It is responsible for reviewing investment opportunities, making recommendations to the Board, and making investment decisions under Board-delegated authority. It oversees progress of transactions until first drawdown, at which point responsibility transfers to the Asset Management Committee.

The Asset Management Committee oversees the Portfolio Management function. It has responsibility for management of all investments post first drawdown until they are fully repaid or exited. It is responsible for reviewing the performance, including investment risk, of the CEFC's portfolio of investments.

The Executive Risk Committee provides oversight of CEFC-wide enterprise risk management. It oversees the system of identification, management and monitoring of risks associated with the CEFC itself, in accordance with the CEFC's Risk Management Framework.

The CEFC publishes its Investment Policies which set out how and where it invests, its performance benchmarks and its approach to managing risk[2].

Capital Structure and Sources of Finance

The Australian Government is the sole shareholder in the CEFC and the annual budget appropriations (AUD 2 billion (USD 1.4 billion) every year from 2013 to 2017 inclusive, as set out in the CEFC Act), are the CEFC's only source of capital. It is not able to raise debt to fund its activities.

The CEFC targets positive financial returns from its portfolio, therefore it aims be self-sustaining over time in terms of its operating costs.

Financing Activities

The CEFC began making its first financial commitments in July 2013. Over the last five years, the CEFC has directly invested AUD 4.8 billion (USD 3.4 billion) in more than 110 individual transactions, with a total project value of AUD 19 billion (USD 13.5 billion). It has also delivered finance for more than 5,500 smaller-scale clean energy projects through co-financings and corporate/climate bond programs.

It has flexibility to invest across the capital spectrum – in equity (including through specialist equity funds), debt (corporate or project) and subordinated debt. This allows it to respond to changing market conditions; lower barriers to clean energy investment; and support the development of a robust clean energy pipeline, by attracting project developers, entrepreneurs and other investors to the Australian

2 Details of the CEFC's investment policies can be found here: https://www.cefc.com.au/media/328406/CEFC-Investment-Policies-June-2017.pdf

clean energy market. However, the CEFC is limited in the guarantees (contingent support) that it can provide. Where it does so, the total potential liabilities under any outstanding guarantees is limited to the CEFC's uncommitted and available funds, thus it does not require additional funding to deal with contingent liabilities[3].

The CEFC's products and project cycle focus allow it to address common renewable infrastructure risks. For example, appetite for construction risk and merchant price risk remains limited among Australian banks and non-bank investors such as funds and insurance companies. Additionally, the market for corporate power purchase agreements is underdeveloped in Australia compared with other advanced economies. When energy retailers have shown reduced demand for power purchase agreements, the CEFC has developed sophisticated merchant energy price risk guidelines that have allowed it to finance partly or fully merchant (uncontracted) renewable energy projects to avoid disruption to the development pipeline. In this way, with the backing of funding from the Government of Australia, the CEFC is able to support clean energy markets through periods of policy transition and market uncertainty.

The CEFC primarily applies a commercial approach when making investment decisions – focusing on projects and technologies that are at the later stages of development – but, given its public policy purpose, it will pursue projects that are perceived by the market to be slightly ahead of the current level of risk appetite. Where there are positive externalities to the project, the CEFC can accept a higher level of risk, or a lower financial return ("concessionality").

As at 31 December 2017, the CEFC's financing commitments were as follows:

- Project finance loans – AUD 1.7 billion (USD 1.2 billion)
- Co-financing programs – AUD 1.1 billion (USD 780 million)
- Equity – AUD 804 million (USD 571 million)
- Corporate loans – AUD 800 million (USD 568 million)
- Climate bonds – AUD 383 million (USD 272 million)

As at 31 December 2017, the sectoral breakdown was as follows:

- Solar photovoltaic – AUD 1.5 billion (USD 1.1billion)
- Wind – AUD 791 million (USD 562 million)
- Other – AUD 795 million (USD 565 million)
- HVAC/Monitoring Systems – AUD 384 million (USD 273 million)
- Lighting – AUD 362 million (USD 257 million)
- Low emission vehicles – AUD 359 million (USD 255 million)
- Industrial process improvement – AUD 234 million (USD 166 million)
- Cogeneration – AUD 163 million (USD 116 million)
- Bioenergy – AUD 151 million (USD 107 million)

Part of the benefit of CEFC support is its long-term investment horizons – for example, the average legal tenor of CEFC project finance loans is 11 years. It can take equity positions in projects which have no specified term.

The CEFC publishes quarterly reports regarding investment commitments. Some relevant examples include:

- **Macarthur Wind Farm, Victoria.** The CEFC provided AUD 50 million (USD 36 million) as part of a debt package of AUD 499 million (USD 355 million) to refinance a 50 per cent stake in the AUD 1 billion (USD 710 million) Macarthur Wind Farm. Other syndicate members were ANZ, NAB, ING, Shinsei, ICBC and EKF. The CEFC's additional finance helped ensure efficient market pricing, encouraged other banks to participate, and demonstrated that developers of large-scale renewable energy projects in Australia can successfully complete a development-refinance-exit cycle.
- **Moorebank Logistics Park, Sydney.** The CEFC is committing up to AUD 150 million (USD 107 million) through a seven-year bilateral term debt facility to assist in providing medium-term finance for the staged construction of a logistics park which will take emissions-intensive trucks off the roads by increasing the use of rail networks to distribute containerised freight to and from Port Botany.

3 See Part 2 Clause 10 "Limits on Guarantees" of the Clean Energy Finance Corporation Investment Mandate. [Online]. <https://www.legislation.gov.au/Details/F2017L00035>.

- **The Local Government Finance Program.** The CEFC provides flexible and competitive fixed-rate, long-term finance for councils, targeting major investment projects with the potential to make a significant difference to a council's energy consumption. Eligible projects include energy from waste, solar photovoltaic, street lighting upgrades and low emission vehicles (including related infrastructure). Finance can be drawn over three years and the Program provides access to fixed rate senior debt up to 10 years in maturity.
- **The Energy Efficient Equipment Finance Program.** This program, offered through the Commonwealth Bank, provides Australian businesses and not-for-profits with lower cost finance for a wide range of energy efficient assets. It offers a 0.7 percent discount on CB's standard asset finance rate for technologies which meet the CEFC's investment guidelines, and provides up to 100 percent of the project cost for those between AUD 10,000 and AUD 5 million (USD 7,000 and USD 3.6 million).
- **Climate Bonds.** National Australia Bank issued an AUD 300 million (USD 213 million) Climate Bond in December 2014, the first by an Australian issuer, which was supported by an AUD 75 million (USD 53 million) cornerstone investment by the CEFC. The funds were earmarked for a portfolio of renewable energy assets and are now supporting wind farms and solar energy facilities located in Victoria, South Australia, Tasmania, Western Australia and New South Wales (NSW), with an estimated total capacity of over 2GW.

Support for Green Finance

Under the CEFC Act, it may only invest in "complying investments" which must be clean energy technologies (i.e. energy efficiency, renewable energy or low emission technologies). Beyond its direct investment into clean energy projects, the CEFC has also committed finance to several clean energy financing 'firsts', including the first climate bonds for the Commonwealth Bank, the National Australia Bank and Westpac; the first certified Australian dollar green bond issued by a Australian real estate investment trust; the world's first climate bond issued by a university; and an investment in Australia's first peer-to-peer green lending platform.

Project Preparation and Technical Assistance Activities

The CEFC aims to encourage dialogue with project developers, and is willing to use its specialist expertise in green sectors to act as a 'sounding board' to help structure bankable projects. It does not have a formal role in project development activities that can be supported through technical assistance (that is, project design, feasibility work or in developing a pipeline of priority public infrastructure projects), but it does respond to government consultations on issues which affect investment in green infrastructure.

The CEFC does have an important role in demonstrating that clean energy projects can be commercially viable. The CEFC has a pipeline of investment opportunities valued at around AUD 9 billion (USD 6.4 billion) at 30 June 2017. This demonstrates growing interest in clean energy investment, which may be related to the role that the CEFC has played in working with investors and project developers.

Performance Monitoring

The main Key Performance Indicator used to assess the CEFC's performance is the ratio of private finance raised for each dollar of CEFC investment. The CEFC states that it achieved AUD 1.80 of private sector finance per CEFC AUD. It also tracked key environmental outcomes at a portfolio level, such as annual and lifetime reductions in carbon and other greenhouse gas emissions. In total, it has 13 different performance criteria on which it publicly reports performance on an annual basis.

Internally, the CEFC's portfolio management and risk and compliance functions track the performance of individual projects and manage risk at both individual project and portfolio levels.

Key Lessons Learned

The CEFC is a specialist financial institution for the clean energy sector, meaning that it has a strong understanding of risks and opportunities that the market finds difficult to assess. This helps the CEFC to play a valuable demonstration role; that is, sharing its sector expertise and 'crowding-in' private investment. In some instances, a cornerstone financing commitment from the CEFC helps projects secure additional private sector growth capital.

New infrastructure banks benefit from a clearly defined charter, well-structured investment parameters, and the ability to make decisions independently of government. A tight charter and a commercial board are required to provide the necessary high standard of governance.