

8 December 2011

Clean Energy Finance Corporation Review

By email: cefc@treasury.gov.au

Dear CEFC Review Board

Financing clean energy

ACCIONA Energy Oceania is pleased to make this submission to the CEFC Review. The ACCIONA group has been building and financing clean energy assets for decades. Our experience spans most of the major commercialised clean energy technologies, markets in thirteen countries and many financing conditions.

Presently, ACCIONA has over 8,000 megawatts of clean energy assets in operation around the world. The Australian wind generation portfolio represents over 300 megawatts of that capacity. Additionally, in Australia we have many hundreds of megawatts of wind capacity in development and pre-construction and an interest in large scale solar generation.

We have reflected on this experience and our incumbent position in writing this letter.

Altogether, we welcome the prospect of the Clean Energy Finance Corporation. We believe it can be most effective by investing in the build-out of the Renewable Energy Target in the short term. As that portfolio matures, the CEFC could reinvest its capital and returns into the following generation of clean energy capacity as the emerging technologies approach commercialisation.

We also see opportunities for the CEFC to usefully invest in the electrical grid, enabling remote areas with great clean energy resources to export electricity to distant demand.

Supporting the Renewable Energy Target

In our opinion, the RET is and should remain the primary driver for the construction of Australia's clean energy portfolio over the next eight years. Most of this portfolio will be new wind generation capacity.

Nevertheless, as a market mechanism, the RET is limited by weaknesses in the markets it depends on, specifically, timidity in the capital market and highly concentrated market share in electrical demand. These factors impede the market from regaining its momentum in constructing new capacity.

The installation of new capacity slowed through 2009 and 2010 due to an oversupply of Renewable Energy Certificates over that period. This oversupply caused the price and relative demand for RECs to fall. However, despite the reform of the RET as at 1 January 2011, a partial recovery of the REC price since and the likely increase in the wholesale electricity price due to carbon pricing from July 2012, the outlook for the immediate future is still relatively subdued. This is because, price aside, the investment market is highly averse to taking revenue price risk in funding clean energy investments and there are very few opportunities to mitigate that risk efficiently.

In this context, we see three commercial opportunities for the CEFC:

- (i) **Provide funding or loan guarantees to new clean energy investments that retain revenue price risk.** This capital could be invested on terms that provide the CEFC with a reasonable prospect of retaining the value of its investment and making a fair return. Usual concepts such as due diligence, security and price would flow from this principle.

Direct funding could take the form of subordinated debt or preferred equity. Projects that draw on this funding may still borrow senior debt, but in lesser proportions than they have traditionally. The senior debt would be sized on conservative market-revenue assumptions and priced accordingly. The subordinated debt or preferred equity would be serviced from revenues above that low-revenue price financing case. Indicatively, we suppose the subordinated investment could fund 30% of a project's capital cost with a capital structure of 40:30:30 (senior debt : subordinated debt : equity).

Alternatively, the CEFC could provide suitably limited, capital-backed loan guarantees. The guarantee would indemnify a relevant project's lenders in the case of defined, adverse market price conditions. This would enable the projects to borrow senior debt as if they had secured a revenue price contract in the offtake market. The projects would pay a fee for the guarantee, much as would apply in the case of a monoline guarantee.

- (ii) **Provide revenue price contracts to clean energy projects.** This concept would involve the CEFC contracting with clean energy projects to provide them with revenue price assurance. In cases where a project retained a market position, these contracts could operate like a swap. Alternatively, where a project contracted with a buyer on a short term basis say two or three years, the CEFC's contract could provide price support beyond the term of the short term sale-contract. Thirdly, the CEFC could credit-wrap a third party buyer where that party lacks the balance sheet sought by project financiers.

In each of these examples, the CEFC would be improving a project's revenue profile with the view to enabling it to raise finance. The CEFC's contracts to the clean energy projects would operate in place of traditional offtake agreements, recognising that the demand market is highly concentrated and, for some time, has been reluctant to write contracts sought by the finance market.

The CEFC would derive returns from providing these contracts by contracting at prices that, on average, are lower than the long term expected price level, ie they're "in the money". In the credit-wrap example, the CEFC could derive a guarantee fee. These

margins or fees would represent a return for the risk-based capital that the CEFC would allocate to support its market position.

- (iii) **Buy and trade RECs to establish a price floor.** The CEFC could fund a trading business to buy RECs in the open market or as the buyer of last resort in order to provide a price floor and create liquidity. This trading business would require capital to fund its acquisitions and to support its open positions.

The trading business would assist clean energy developers in gaining finance by providing price assurance and liquidity with respect to their prospective REC sales.

In each of the ideas we cite above, the CEFC would be investing funds to support clean energy projects in raising debt and/or equity finance from the private sector. We regard these as immediate opportunities and believe they should be limited in time, say for the next five years. As the market matures, the CEFC could sell down its investments to alternative investors, for example institutional equity investors or capital markets lenders or renegotiate/redeem its guarantees etc. The CEFC would then be placed to reinvest its capital in future projects within the RET or otherwise. We see two prospects for the market to mature in a way that can facilitate that exit process: firstly, for electricity and REC demand and supply conditions to realign as the surplus of RECs dissipates and prices increase and secondly, for capital investors to gain more confidence in these prices.

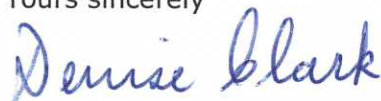
Grid

Australia's electricity grid was built for its twentieth century, carbon-heavy approach to electricity generation. To build an alternative, clean energy portfolio requires that we invest in corresponding changes to the electrical grid. This investment should support a more dispersed network of electricity generation. It must also reach areas that are rich in clean energy resources and other attributes such as low population density and low value land but today lack sufficient connections to the grid. The Eyre Peninsula in South Australia is one such area. However, to support the construction of the hundreds of megawatts of wind generation assets that the Eyre Peninsula can sustain, we need a large investment in the electrical grid so that the electricity can be exported to load centres.

Recognising that new grid is necessary, the CEFC could invest in new transmission infrastructure reaching areas with significant wind or solar resources. The CEFC would receive a return on its investment over time as the generating capacity is connected and pays for transmission rights.

Building out the grid in this way should also create benefits in regional development and employment. In directing investment in new capacity to remote, low-populated areas, the grid investment may also contribute to better overall acceptance of renewable energy and soften community concerns about noise and inequity associated with how the benefits of renewable capacity in populated areas are shared.

Yours sincerely



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