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Submission to the CEFC Review Panel Regarding CEFC Design

CVC Limited is pleased to provide this submission on the CEFC design. Each of the questions posed in the "Request for Submissions" document are addressed below.

The suggestions in this submission are based on over 10 years experience in commercializing clean energy technologies in Australia.

The CVC Group has experience in financing or developing wave, geothermal and wind technologies and projects. It has also completed due diligence on companies and projects representing every aspect of the Clean Energy industry including solar, co-gen and smart grid technologies. The Group's experience is that clean energy projects that are exposed to wholesale power prices are not economic because:

1. The cost of capital in Australia is exceptionally high, particularly as project debt is not available unless a Power Purchase Agreement (PPA) has been secured.
2. PPA's are not available. This is in part because the electricity industry structure in Australia is dominated by vertically integrated monopolies.
3. There is no reliable long term forward market for REC's that would allow price risk to be managed.

Smaller projects that are embedded in the grid and sell power at retail prices may be economic. However these rely on support of a host company to take the power. Host companies rarely want to commit capital or management resources to make these types of projects happen.

More information regarding CVC's Renewable Energy Equity Fund (REEF) and the CVC Sustainable Investment fund can be found on our website at www.cvc.com.au.

1. How do you expect the CEFC to facilitate investment?

By:

1. Taking on the risks that are too high for the private sector
2. Lowering the cost of capital for clean energy development

Right now the risks associated with commercialising clean energy technologies and projects are very high. Particularly for emerging technologies where technology risk is coupled with financial market and regulatory uncertainty. Regulation (RECs and state based schemes) currently drives the off-take price for clean energy projects and so regulatory risk is a very significant part of a project assessment.

Like the IGCC, we believe that investments that will help to de-risk companies and projects include:

- Equity (ordinary, preferred, first loss)
- Debt (mezzanine, junior)
- Hybrid/structured financings
- Loan guarantees (repayment of principal & interest by borrowers)
- Refinancing guarantees post-construction

We agree that these could be direct investments or investment through pooled vehicles/fund structures.

The creation of a 10 year forward market for RECs that would allow hedging with a credit worthy counter party regardless of Government policy changes could also be helpful.

Once technologies/projects have progressed and been de-risked then private capital is likely to flow.

2. Are there principles beyond financial viability that could be used to prioritise investments, such as emissions impact or demonstration affect?

Yes. Financial viability will not be an adequate measure of whether an investment is a "Clean Energy" investment. The objective of the CEFC is to "*overcome capital market barriers that hinder the financing, commercialisation and deployment of renewable energy, energy efficiency and low emissions technologies.*"

There must be an assessment of the long-term emissions impact of potential investments (by 2020 or later) and this should influence the merit order of investment opportunities. We acknowledge that predicting long term emissions reduction is difficult but it is essential that a consistent methodology is applied so that opportunities can be compared on an apples-with-apples basis.

3. What are the opportunities for the CEFC to partner with other organisations to deliver its objectives?

PPPs have worked in the past and should be part of the mix here. The key to successful partnerships will be coming to agreement on the risk return allocation as discussed in question 1.

Consideration should also be given to partnering with the private sector to create pooled funds.

4. How could the CEFC catalyse the flow of funds from financial institutions?

Discussed in question 1 above.

5. What experiences have firms in the clean energy sector had with trying to obtain finance; have term, cost or availability of funds been the inhibitor?

For smaller projects a key barrier is scale. Due Diligence costs often absorb the otherwise attractive returns.

The other key barrier is risk:

- Technology risk
- Regulatory risk
- Refinancing risk, and
- The risk that follow-on investment will not be available, particularly in this time of increased financial market uncertainty.

These risks mean that finance has not been available.

CVC has had deep experience in this area and we are happy to provide more detail.

6. What non-financial factors inhibit clean energy projects?

James Cameron of Climate Change Capital noted that many clean energy initiatives face a problem of "speed and scale". CVC agree with this.

Speed:

Unlike some technology developments (e.g. IT initiatives), clean energy technologies take many years to develop and require very patient investors. Energy technologies require lengthy testing and approvals at every stage (prototype, pilot, early commercial project etc.). This takes years, locking up the capital of

early stage investors and lowering their annualised returns. This means that there is less money circulating in the “system” for new clean energy investments.

Scale:

As discussed in question 5, scale is also a key barrier. Many clean energy projects are small. They are small because they are distributed energy projects. Distributed energy and the smart grid have the potential to revolutionize our energy supply eco-system and drastically reduce emissions over the long term.

However, small scale projects struggle because the transaction costs (engineering, due diligence, legals, approvals etc.) are a significant proportion of the overall cost and compromise returns. These costs are often insignificant in large infrastructure projects.

We believe that the CEFC could play a useful role in helping to “bundle” a number of these small projects and use this scale to lower the average transaction cost per project.

7. Are there special factors that inhibit energy efficiency projects?

Yes. Scale is a key barrier for energy efficiency projects. Energy efficiency projects often deliver a high IRR but they are usually relatively small and so the returns are not material to the host’s bottom line. The projects are therefore given a low priority.

Financing a third party to undertake these projects has been a solution in other jurisdictions and could work well if a white certificate scheme is introduced in Australia. This is discussed further in the section below.

8. How do you see the CEFC fitting with other government initiatives on clean energy?

It appears that there is good potential for the CEFC to integrate with other government clean energy initiatives:

- *The Clean Technology Investment Program.* In addition to grants, some clean energy projects in manufacturing plants may benefit from more commercial funding such as that outlined in question 1 above.
- *White certificate scheme or other national energy efficiency initiatives.* Energy efficiency projects may not be material for the project host but they could be material for a third party if there is a mechanism for that third party to receive some of the project returns. The CEFC could help to finance that third party. We would encourage the CEFC to participate in the design of

any energy efficiency scheme to ensure that the scheme can attract finance. We also recommend that CEFC work closely with Low Carbon Australia in this regard.

- *Renewable Energy Venture Capital fund (REVC)*. We believe there will be co-funding opportunities for CEFC and REVC, particularly at the pilot and early commercial project stage.
- *Emerging Renewables Program*. In addition to grants, some renewable energy projects may benefit from CEFC's more commercial (but low cost) funding. Potential structures for this funding are outlined in question 1 above. CEFC may also provide follow on funding after the Emerging Renewables Program has successfully moved projects to the next stage.

Overall we think it is important to note that private sector funds would be flowing if the risk return balance was attractive. At this stage of clean energy development in Australia the risks are high and the returns are low. This is the market gap that the CEFC needs to fill and we welcome its development. At the risk of stating the obvious, if the CEFC is to fulfill its objectives then it will need to accept high risks and relatively low returns.

Thank you for considering this submission. Please do not hesitate to contact us if you would like any further information.

Best regards

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