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CLEAN ENERGY FINANCE CORPORATION

EXPERT REVIEW

RBS INFRASTRUCTURE ADVISORY RESPONSE

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RBS Infrastructure Advisory would like to thank the CEFC for the opportunity to make this submission to the Expert Review and would welcome the opportunity for further discussion.

RBS Infrastructure Advisory Introduction

RBS Group (Australia) Pty Limited ("RBS"), is a leading provider of investment and corporate banking products and services in Australia and New Zealand. RBS' Infrastructure Advisory group is recognised as a leading participant in the project finance and public private partnership (PPP) market.

The success of RBS is illustrated by:

- Advising Solar Dawn on its successful bid for the Solar Flagships Programme;
- Successfully delivering over 25 projects with private finance throughout Australia and New Zealand;
- Being recognised as an industry leader in structuring and funding major infrastructure, utilities, renewable energy and transport projects; and
- Its long term relationships with institutional debt and equity providers and energy and infrastructure players.

The Infrastructure Advisory team combines expertise in:

- Project sponsorship and development;
- Financial advisory, project finance, capital structuring, infrastructure and utilities financing and equity;
- Project management including stakeholder liaison, design management, project co-ordination and operations management;
- Debt and equity arranging; and
- Investor and bank relationships.

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

There are many ways in which the CEFC can facilitate investment.

Although there are many non-financial methods that the CEFC could potentially employ to assist the development of renewable projects and technologies, we have chosen to not specifically address these due to the current scope of the CEFC. We have also chosen to focus primarily on the assistance which the CEFC could provide to renewable projects as this is our area of focus.

There is sufficient volume in the financial markets for clean energy projects, meaning that it may not be the most appropriate use of CEFC funds to displace existing private investment. Investment facilitation will come from:

- **Providing assistance to projects at both an early and late stage of development to address specific finance market gaps**

This could be in areas where private investors currently require an investment return which makes specific projects unviable or where private investors are currently unwilling to invest.

- **Funding projects at the early stage**

Early stage projects often require support for development costs including site selection, permits, scoping and design. The CEFC could form partnerships with existing project developers and provide funding to develop projects to a later stage, at which point they could be sold at a profit or further developed with CEFC assistance. This would serve to increase the supply of projects available for investment by both the CEFC and private investors.

- **Improving project economics or risk allocation**

Projects at a late stage of development have already been fully scoped and often have a detailed financial case to support their development. However, many potential projects do not progress beyond this stage as private capital is either available at an expected return which makes the project financially unviable or is unavailable. This occurs more frequently in the renewable energy sector due to the high cost and higher risk of the technology. In both these cases, the most effective way for CEFC to assist is via a direct investment of capital. Possible forms include subordinated debt, ordinary equity or preferred equity and should be selected according to the availability of competing private capital. In order to provide a benefit to the project, this investment would need to be made at a lower return or greater amount than would otherwise be available from private investors. Grants can also improve economics but would not deliver a return to the CEFC.

An alternate method of providing assistance to projects at a late stage of development is through reducing the perceived risk of projects, to attract financiers. This can be achieved through a number of mechanisms including contingent investments such as loan guarantees and underwriting agreements. In these structures, the CEFC receives a fee in exchange for protection from certain risks much like in an insurance contract. Contingent investments facilitate direct private investment by reducing the risk which private investors bear in the case that the project fails (in the case of a loan guarantee) or that other investors cannot be found (in the case of an underwriting agreement). The key advantage is that a larger amount of investment can be facilitated for a given amount of CEFC capital as upfront investment is not required, whilst the CEFC can earn a return through the fees charged. However, as the capital required by the CEFC depends upon the probability of the contingent investments being called, risk would need to be carefully managed.

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

To ensure the viability of the CEFC and ensure that capital from investments can be reinvested into subsequent projects we would expect that the financial viability of any given project must be the primary criteria for investment.

However, we appreciate that the CEFC also serves to achieve the broader objectives of the Clean Energy Future Package such as reducing carbon emissions. Therefore, investments which have a greater emissions impact or demonstration effect should be prioritised provided that they are also financially viable.

Furthermore, the impact of CEFC investment decisions on the flow of private investment should be considered. Private investors strongly prefer a steady pipeline of projects with consistent characteristics. This allows them to develop appropriate expertise and compare project risk on a more objective basis. Similarly, larger projects are generally preferred to smaller projects due to economies of scale in project development and financing. By being responsive to the investment preferences of the private sector, the CEFC can not only ensure a consistent flow of private capital but also develop the expertise of the Australian renewable energy investment community.

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

Partnering with other organisations will be essential to deliver the CEFC's objectives at all stages of project development. Strong partnerships with both state and local governments are of particular importance. These will ensure that appropriate development approvals and permits can be issued in an efficient and timely manner and that priorities can be aligned across all levels of government such that resources are directed in an effective manner. State government-owned corporations in the energy distribution and generation industries should be included in these partnerships due to their importance for items such as power purchase agreements and operations and maintenance.

The CEFC should also partner with private sector organisations including project developers, debt financier and equity financiers as well as actively participate in industry forums. The nature of the partnership will vary depending on upon project stage and the nature of the partnership. For example, partnerships with developers could involve the CEFC investing partial development costs for priority projects with the expectation of receiving part of the development profits. At the project financing stage, strong partnerships with banks and equity investors active in clean energy financing will ensure the reliable and competitive availability of private capital.

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

Despite the GFC, large pools of private capital are available for projects with desirable risk/return characteristics.

The CEFC can catalyse the flow of funds from financial institutions by reducing project risks and improving project returns rather than substituting for private investment.

Project risks for private investors can be reduced by:

- Investing in newer technology projects ahead of the private sector to both reduce perceived project risk and assist in commercialisation and knowledge transfer.
- Protecting investors from particular kinds of losses which are difficult or costly to insure against in private markets such as political risk, technology risk or longer term energy market risk.
- Acting as counterparty to power purchase agreements (PPAs) with longer tenor than would ordinarily be available in the Australian electricity market. Projects would benefit from the strong credit rating of the CEFC and longer tenor would allow for slower debt amortisation. The early years of the PPA could be matched by an equivalent PPA with a commercial provider.
- Providing a refinancing commitment which guarantees an exit for long-term bank finance. This could be after the completion of construction or early in the operations phase of a project. A refinancing commitment would allow banks to reduce their required rate of debt amortisation.

Project returns can be improved by:

- Investing alongside private investors at a lower expected return in order that private investors receive a sufficient return to ensure project viability.
- Providing long-term subsidies to supplement the market price of electricity
- Providing loan guarantees in order to reduce the cost of private debt financing
- Providing subordinated debt for projects.

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?

There is strong interest from both institutional fund managers and banks to invest in the clean energy sector. However, clean energy projects must compete for finite funding with other available investment opportunities. This competition for funds can result in both higher costs and a lack of availability in the case of higher risk projects.

The Australian bank finance market is characterised by typical loan tenor of 7-9 years, which is shorter than in overseas markets. This is problematic for clean energy projects as debt must be amortised more quickly than would be the case for overseas projects, limiting both the quantum of debt and associated equity returns.

The term, cost and availability of finance for a clean energy project are also directly influenced by the terms and availability of a power purchase agreement (PPA). A PPA provides a contracted long-term electricity price which provides much greater revenue certainty than selling electricity directly into the national electricity market as a merchant. For many bank and equity investors, a strong PPA is a prerequisite to providing financing as they are unwilling to bear substantial merchant risk. The concentrated structure of the Australian electricity market provides a limited number of potential PPA counterparties in each state and grants these counterparties substantial market power. Where PPAs are available, they are shorter term and with less favourable pricing than available in overseas markets. This results in shorter term, higher cost and less available finance.

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

Whilst our focus is primarily on our role as a financial advisor, some non-financial factors which we have observed to inhibit clean energy projects are:

- Number of permits required and complexity of application processes
- Long development and construction timelines
- Uncertainty in carbon policy and the LGC/REC market
- Lack of co-ordination between Commonwealth, state and local government policies
- Perceived risk of renewable energy technologies and resources
- Many green energy projects and ventures are too small to attract the attention of large multilateral financial institutions, a key investor in the energy sector.

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

This is not our business's area of focus

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

The CEFC will act to support existing government initiatives on clean energy with the assistance of private investment capital. Specifically, the CEFC will assist in the achievement of the Renewable Energy Target (RET) that 20 per cent of Australia's electricity supply will come from renewable sources by 2020. CEFC assistance could be used to assist lower the cost of renewable electricity prices for both industrial and residential consumers of energy. This will assist these groups in the transition to a lower carbon intensity economy and potentially reduce the inflationary pressures of any carbon tax or trading scheme which is introduced. Furthermore, the availability of a reliable partner

such as the CEFC will likely increase the participation of superannuation funds in the renewable energy sector.