CEFC SUBMISSION ON SOCIAL IMPACT INVESTING

FEBRUARY 2017

INTRODUCTION

The Clean Energy Finance Corporation (CEFC) was set up as an independent Commonwealth statutory authority by the Clean Energy Finance Corporation Act 2012. The $10 billion entity operates with a sustainable, commercial focus providing finance (debt and equity) for projects eligible under its Act and Investment Mandate.

The CEFC was established to facilitate increased flows of finance into the clean energy sector and, among other things, it supports the development of a resilient, balanced, and secure electricity system through its investment activities.

The CEFC has extensive experience in social impact investing given that all its investments to-date generate social and/or environmental co-benefits in addition to earning a financial return. Across its entire portfolio, the CEFC has delivered more than $3 billion in cumulative investment commitments, contributing to projects with a forecast total capital investment of over $8 billion (as at December 2016). These projects include benefits such as emissions reduction, reducing and recycling waste, improving energy efficiency and helping low-income earners reduce their energy bills.

The CEFC was invited to provide a submission into the Government's Social Impact Investing consultation. This submission will share our experience and lessons learnt from investing in this area and demonstrate how the Federal Government, through the CEFC, is making a positive contribution to the social impact investment market.

CHALLENGES IN SOCIAL IMPACT INVESTING

The CEFC's investment decisions are made on a rigorous commercial basis independent of Government by a pre-eminent Board of accomplished Australians – all with a private sector background.

The CEFC's public ownership and purpose requires the CEFC to invest more time, effort and resources into transactions which have public policy benefits.. Whilst investments we make earn a return on investment, they often face barriers to attracting investment because:

- **Size**: They may be smaller than most commercial banks are willing to consider
- **New and complex projects:** They may involve complex or new concepts or technology that investors do not understand and can take more than a year to reach financial close.
- **Remote projects:** They might be in remote locations and involve special challenges like transmission issues.
- **Specialised skill set**: The transactions might require a range of skill sets that are not easily assembled in larger financial institutions such as energy resources, internationally recognised technology and high-level engineering skills.
- **Innovative finance structure**For many projects, a simple, short-term debt loan may not be suitable for the project and its income stream. The project may require an innovative finance structure that works around complex issues to do with project implementation and revenue streams.
- **Tenor**: Many clean energy projects have payback periods in excess of typical corporate finance terms (3 to 5 years) and therefore require longer tenor with debt service terms aligned with the revenue streams.
- **Uncertain or policy-dependent revenue streams**: Large-scale renewable energy projects rely on large-scale generation certifications ("LGCs") for a large portion of their revenue. Because

this source of revenue is linked to policy, this can create risks for investors that policies may change.

Whilst these are the challenges we face investing in clean energy projects, these challenges are not unique and are similar to many challenges faced by investors working with social-impact investments. The CEFC's structure and purposes means we can overcome a lot of these investment barriers and provide loans for smaller projects or projects that involve new and complex technologies. We are able to provide innovative finance structures and longer tenor where needed. The CEFC's sector specialised team enables it to consider investment in all classes of capital together, from equity through to debt with structuring responsive to client needs.

The CEFC's participation in the market provides liquidity to ensure efficient pricing. Our lower cost of funds, flexible structuring and capacity to match the term of the financing to the life of the assets has allowed us to de-risk transactions so that private financiers become involved.

The CEFC has helped create a demonstrable improvement to the flow and diversification of funds into the clean energy sector – in particular, attracting funds from new sources, including European and Asian institutions for the first time in this sector in Australia, working to crowd-in (not crowd-out) capital from new and existing sources.

Ultimately, for social impact investments to be more widely bankable, it may be necessary for incentives that encourage private sector investment. For example, ongoing payments for achieving particular social objectives, in the same way that the LGCs provide a financial incentive for producing electricity using renewable technologies. Similarly, ongoing payments to provide social housing, along with other policy measures, can make delivering social objectives more financially attractive to the market.

CEFC EXPERIENCE IN SOCIAL IMPACT INVESTING

Social impact bonds

An important and growing form of social impact bond in Australia is the green bond market. Green or climate bonds are used to finance a range of clean energy, energy efficiency and other environmental initiatives. The CEFC has been very active in driving the establishment of Australia's green bond market, as part of our role in helping expand the clean energy investment market. Over the past four years, there has been significant growth in the green bond market in Australia, both in the scale of capital raisings and the diversity of the underlying assets. The CEFC has been involved in four green bond issuances to-date with Westpac, National Australia Bank, Monash University and FlexiGroup.

The investor appeal of this important new asset class is underscored by the fact that all Australian issuances have been fully subscribed immediately after announcement – in fact, demand has been so strong that many issuances were healthily oversubscribed. This reflects a broader market direction, where the investment dollar is swinging towards the cleaner end of investment options.

We have now seen green bonds issuances in Australia by commercial banks, international development banks and universities. State and local governments are already showing interest in issuing green bonds, with the Victorian Government issuing its first green bond in 2016 and Queensland set to follow.

Large scale investment funds

The CEFC also has a lot of experience working with larger-scale investment funds where investors pool funds and direct those funds towards projects with positive environmental impacts. For example, the CEFC has worked with Investa Commercial Property Fund, the AMP Capital Wholesale Office Fund and EG Funds Management – three funds (with a total of more than $10 billion in assets under management) that are targeting improvements in energy efficiency and sustainability in the property sector. The CEFC also worked alongside mid-tier investors as part of the $500m Palisade Renewable Energy Fund to accelerate the development of a pipeline of clean energy projects and with the Australian Bioenergy Fund to develop bioenergy and waste-to-energy projects in the local government, mining, forestry and agriculture sectors.

Institutional investors are backing green bonds and green investment funds because they target areas viewed as increasingly important to their clients, without increasing their credit risk or lowering their returns profile. Green bonds and green funds also allow investors to balance their risk across a large number of projects, and maintain greater liquidity than possible through direct infrastructure investments.

A growing number of super funds and their members want to invest in clean energy to take advantage of the sector's future potential. Members are increasingly pushing their super funds to adopt mandates which support clean investment, a clear indication that Australia's $2 trillion superannuation fund pool, the fourth largest in the world, will provide a significant source of demand for Australia's emerging green bond and green investment fund market.

Individual businesses

The CEFC has worked with a number of individual businesses to achieve both a financial and environmental outcome through their investment, for example businesses that capture harmful landfill emissions and turn it into energy, businesses that capture harmful waste-coal mine gas and turn it into energy and food producers that turn organic waste into energy to power their operations and cut emissions.

Through these investments, the CEFC has found increasing investor appetite for investments that earn both a financial return as well as provide a social or environmental return. Our experience to date is that if investment products can be delivered, there will be buyers for them.

We are seeing increasing diversity in both the types of products issued and the purposes for which they are used for as well as the types of investors that are expanding into this market. For many businesses, it helps to protect reputational risk, respond to client and customer demand, or provide the business with a competitive edge.

Rather than individually detail each of our investments, the CEFC has selected one case study (below) in which to demonstrate: how social impact investing can work in Australia; how the Federal Government can facilitate such investment by working with State Governments, the private sector, communities, and service providers; and the types of outcomes possible from such investments.

CASE STUDY: ST GEORGE COMMUNITY HOUSING SUSTAINABILITY LIMITED

The Project
In 2015, the CEFC reached an agreement with community housing provider, St George Community Housing (SGCH) Sustainability to provide a loan of up to $60 million for the construction of over 140 new high-performing energy-efficient homes. The homes are mainly in Sydney's south and because of the CEFC's loan, will now be designed and constructed to an average 7-star Nationwide Household Energy Rating Scheme (NatHERS) rating, much higher than the NSW average of social and affordable housing (3.5 star NatHERS)

SGCH is the largest community housing provider in New South Wales, housing over 8,300 people in 4,300 homes. CEFC finance will also be used by SGCH to upgrade some of the 4,300 properties it already owns or manages to improve their energy efficiency and lower tenants' energy bills. The total project will cost around $128 million.

The CEFC provided a ten-year loan and a small concession (50 basis points) conditional on SGCH using this amount to fund tenancy sustainability initiatives on both new and existing homes, such as installing smart meters, window glazing, insulation, LED lighting, energy efficient appliances, solar PV and energy usage reporting. This transaction helped to bridge a funding gap in the community housing sector where private sector finance tends to be short term, thereby mismatching the typically long lived housing assets.

Social and environmental Impact

This project has 3 key social and environmental benefits:

1. Reduces the cost of living for low-income and disadvantaged households, through lower energy bills

2. Creates a better & healthier living environment for those in social housing

3. Reduces emissions

Low-income earners tend to live in buildings with poorer energy efficiency, leading to higher energy costs. High energy costs can have significant financial and health effects on households in community housing. This project will directly benefit low-income and disadvantaged households through lower electricity bills. In addition, the project is expected to reduce emissions by ~94,000 tonnes CO2. The benefits of greener homes go beyond the immediate cost and emissions savings. According to the Green Building Council of Australia, the better ventilation and indoor environment quality of greener housing has a positive impact on the health and wellbeing of residents

“Improving the energy efficiency of low income households in social housing will help improve affordability, climate resilience and create a better living environment for tenants. People on low incomes are particularly impacted by rising energy prices, but they lack the capital for energy efficiency upgrades and are more likely to own inefficient appliances.

The CEFC is able to make finance available over a longer period, allowing the benefits of lower operating costs to be passed on to the tenants. This model will help make such investments more appealing for the housing sector to meet growing needs for more sustainable social housing” Oliver Yates *CEO, CEFC*

“CEFC’s long term finance will enable SGCH to build new affordable homes at well above minimum standards in Australia. In addition, it will also improve the lives of social and affordable housing tenants and at the same time reduce SGCH’s operating costs. The more cost savings the more we can reinvest into housing for those most in need.” Trevor Wetmore Acting CEO SGCH

Financial impact

Even with the small concessionality the CEFC provided on its loan to SGCH, the CEFC is still expecting to earn a return on its investment commensurate with other investments within its portfolio.

Opportunities

As at January 2017, over 50 new high-performing, energy efficient homes have been built and tenants have already started moving in. The loan to SGCH is the first of its kind for the CEFC, which is aiming to demonstrate the potential for a community housing sustainability program. The success of this investment has led to further interest, with the CEFC expecting to announce its second investment in social housing before the end of the financial year.

SUMMARY

Through our investments to date, the CEFC has learnt from experience that it is possible for the Federal Government to facilitate investments in Australia that have positive social and environmental benefits in addition to a return on investment.

Moving forward, one of the CEFC's primary focus areas is social and affordable housing and how we can work with this sector to improve the design and liveability of homes as well as reduce energy bills for low-income tenants. For example, there is potential for the CEFC to provide seed funding for the development of a dedicated social housing finance fund for new developments (designed to a higher energy efficiency standard). Ultimately this type of housing fund would aim to attract other investors and potentially issue capital market bonds.

The CEFC sees a lot of opportunity in this area and has developed the skill set and has the funds available to increase investment in supporting these initiatives. We have found there is a strong and growing appetite from state and local governments, not-for-profits, investors, and the community for further investment in this area, particularly in relation to investments that have positive climate and environmental co-benefits.

ABOUT THE CEFC

The Clean Energy Finance Corporation invests, applying commercial rigour, to increase the flow of finance into the clean energy sector. Our mission is to accelerate Australia's transformation towards a more competitive economy in a carbon constrained world, by acting as a catalyst to increase investment in emissions reduction. We do this through an investment strategy focused on cleaner power solutions, including large and small-scale solar, wind and bioenergy; and a better built environment, with investments to drive more energy efficient property, vehicles, infrastructure and industry. The CEFC also invests with co-financiers to develop new sources of capital for the clean energy sector, including climate bonds, equity funds, aggregation facilities and other financial solutions. The CEFC operates under the *Clean Energy Finance Corporation Act 2012*.