INVESTOR GROUP ON CLIMATE CHANGE

Submission to:

CLEAN ENERGY FINANCE CORPORATION STATUTORY REVIEW

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EXECUTIVE SUMMARY

The Investor Group on Climate Change (IGCC) supports robust, investment-grade policies to reduce emissions. Investors are looking for policy which delivers clear and transparent market signals which support investment confidence and better risk management over time and which bring private sector investment to market.

The Clean Energy Finance Corporate (CEFC) has played a key role in supporting Australia’s rapidly growing clean energy sector. Through its investments in the deployment of emerging technologies, the CEFC has been successful in leveraging private sector finance and improving investor confidence in the technologies and supporting the emergence of investment structures required to support Australia’s transition to a low-carbon economy.

The CEFC has further potential to increase the level of funds and investment available to the clean energy sector through greater engagement with institutional investors. Barriers remain that prevent institutional investors from participating in the clean energy sector and there remain opportunities for increased engagement with this portion of the finance sector.

The CEFC is well placed to use its funds to make strategic investments that would further de-risk low-carbon innovations and assist in establishing the kinds of investment products that would facilitate significant investments from institutional investors.

There are a number of amendments to the CEFC investment mandate that have the potential to extend institutional investment into the necessary responses to climate change.

Significantly, major investment in adaption and climate resilience for property and infrastructure will be required in the near future to both protect buildings from the physical effects of climate change and preserve asset value.

An expansion of the CEFC mandate into low carbon and *climate resilient* measures and project opportunities provides a new avenue to respond to climate change, while delivering commercial returns.

IGCC would be happy to facilitate further engagement with the institutional investor community to discuss the operation of the CEFC and issues set out in this submission.

1 Introduction and overview

The Investor Group on Climate Change (IGCC) represents Australian and New Zealand institutional investors with over $2 trillion of funds under management, along with members of the investment community focused on the impacts of climate and energy issues.

IGCC members are invested across the Australian economy and are part owners of most of Australia's large companies. As managers of retirement savings and pooled investments we are concerned with the evident and increasing impacts of climate change on the global and Australian economies and the flow through impacts for investment returns.

It is increasingly apparent that there is a global transition underway, aimed at reducing the emissions intensity of economic activity to stabilize global warming at less than two degrees Celsius below pre-industrial levels, and move towards a net zero emissions economy by the second half of the century. These are the goals set out in the Paris Agreement and ratified by Australia.

This economic transition will also create significant potential investment opportunities for investors and for the Australian economy. The challenges of transitioning to a net zero emissions economy will require an unprecedented level of capital investment and represent a massive market signal to the global economy. The IEA estimates that $75 trillion in low carbon investments and energy efficiency combined will be required to limit global warming to <2°C[1].

Australia's response to climate change needs be inclusive of considerations for the economic and investment implications of the global response to climate change. This includes the setting out a practical pathway for ensuring Australia's economic competitiveness in a carbon constrained global operating environment over the longer term.

The Clean Energy Finance Corporation (CEFC) has played, and should continue to play, a crucial role in creating an investment environment that supports the emergence of low-carbon technologies and innovations.

In responding to the questions posed by the review's consultation paper, the IGCC has sought to provide an investor perspective on the role the CEFC serves in supporting the emergence of Australia's clean energy sector, while seeking to identify gaps and opportunities for the CEFC to further support the participation of institutional investors.

IGCC has also included a number of case studies to demonstrate institutional investor engagement with the CEFC.

IGCC welcomes the opportunity to provide a submission to the CEFC Statutory Review.

[1] IEA World Energy Outlook, 2016.

1.1 Investor Priorities

In recent years, a significant shift has been occurring in how business and the financial community views climate change and the need to reduce greenhouse gas emissions, including through investments in clean energy technologies. Specifically, carbon has moved from being seen solely an environmental issue to being understood as representing an economic risk. Whether physical, regulatory, market-driven or technological, climate change has financial implications for business and for investors.

Australia needs to be managing carbon risk as an economic and a financial risk and working to facilitate an economically efficient transition to a net zero emissions economy in line with global commitments under the Paris Agreement.

Continuing to build the expertise, skills and capacity throughout the sector to manage climate change related financial risks and opportunities will underpin Australia's future economic profitability in a net zero emissions global economy.

At the same time, a robust and stable policy framework, including direct support that is provided to the sector through public finance, will drive greater levels of investment into low carbon solutions and will help smooth the economic risks associated with structural decarbonisation of the Australian economy.

1.2 The implications of climate change for investors

The IGCC has been addressing and considering the issue of climate change as a financial consideration for over a decade. In the past 18 months, we have also seen a deepening in recognition across the broader business community of the financial and investment implications of climate change.

The Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD) released their final recommendations in mid 2017. Launched in December 2015, the work of the Taskforce has – and will continue to be – hugely influential in driving strategic integration and harmonised corporate disclosure of climate change risks and opportunities.

In order to meet our national emissions reduction targets under the Paris Agreement and facilitate investment in the low carbon and clean energy sector, Australia needs a robust approach to public finance which delivers the long-term certainty and funding required to unlock private sector capital and accelerate investment in clean energy and energy productivity opportunities.

An independent financing institution is a key complementary policy measure to stimulate the transition to a low carbon economy. Public finance bodies such as the CEFC have a critical role to play in deploying public sector capital to encourage private sector investment in areas where private sector capital is needed to fund the transition to a low carbon economy.

The CEFC has a key role in facilitating the entry of investors into the emerging clean energy sector, as well as working to identify the gaps in the current investment environment.

IGCC believes that a clear investment mandate and stable, long-term funding support for the operation of the CEFC are critical for building investor confidence in the transparency, certainty and longevity of the low carbon financing framework in Australia.

Investor Case Study: AMP Capital Wholesale Office Fund
The AMP Capital Wholesale Office Fund has successfully partnered with the Clean Energy Finance Corporation to support the reduction of emissions produced by With an investment contribution of $100 million into the fund, the CEFC will support AMP to achieve targets of zero net emissions from the funds office and commercial buildings. AMP has committed to reach zero emissions for properties within the fund as well as lifting the average NABERS rating of the portfolio to at least 5.5 stars by 2030. The fund's property portfolio includes office assets demonstrating industry leading sustainable design principles, including the six-green star rated commercial office building 700 Burke Street in Melbourne. AMP has committed to exceeding Science-based targets for emissions reductions, including emissions intensity reductions of greater by 55 percent by 2050. The partnership between the CEFC and AMP Capital demonstrates the ability of institutional investors to lead the process of decarbonisation and sustainable development while delivering investment grade returns to investors.

2 How has the Australian Clean Energy Sector evolved?

In the past five years the clean energy sector in Australia has undergone substantial transformation. The falling cost of technology, the increasing penetration of distributed energy in the National Energy Market and ongoing policy volatility with the introduction then repeal of a carbon price and the review of the Renewable Energy Target have all been characteristics of the investment landscape for clean energy. There have also been substantial wholesale and retail price shifts for energy consumers which have changed the economics of energy investment.

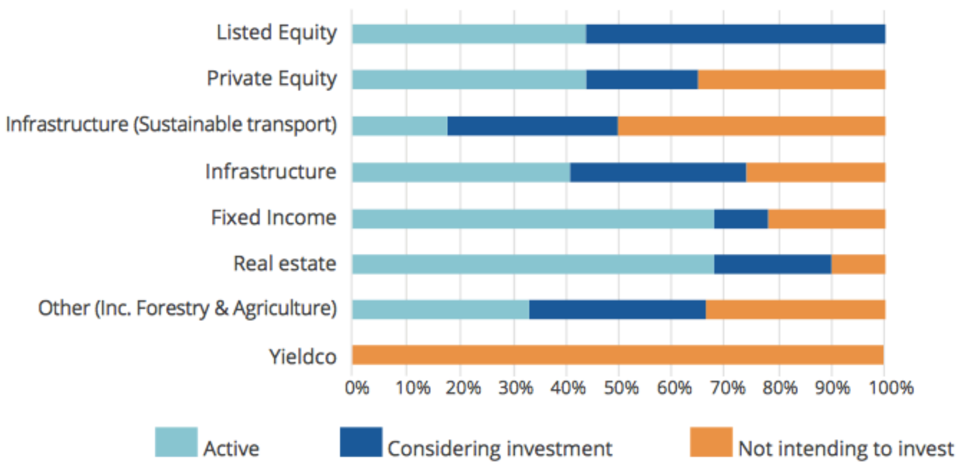
At the same time, major shifts in global policy frameworks (such as the finalisation of the Paris Agreement) and the acceleration of the deployment of low carbon and energy efficient technological solutions have provided a strong market signal that decarbonisation is a defining investment theme of the energy sector for the foreseeable future.

From an investment perspective, Australia's clean energy sector has matured significantly since the formation of the CEFC in 2012. The growing appetite for green bonds and aggregated financing products have brought more sophisticated investors into the market, increasing the levels of capital available to facilitate an accelerated transition towards a low carbon economy.

In the *Road to Return: Institutional Investors and Low Carbon Solutions*[2] report released by the IGCC in 2017, a survey of investors identified active areas of low carbon investment (by asset class and market) and some of the barriers that prevent funds being made available to support green investment.

Over half of respondents have already allocated funds to green investments across multiple markets and asset classes. They also intend to increase green investments over the coming years. Real Estate and Fixed Income dominated the investment landscape for participants, although, allocations to green investments were made across a broader range of asset classes.

Asset Classes in which investors are currently active or considering investment



More than 90 per cent of institutional investors surveyed recognised a lack of opportunities with appropriate risk-return objectives as a perceived barrier to making green investments, including those in clean energy and low-carbon developments. These are discussed further below.

Against this landscape, there remains a clear and identifiable role for the CEFC to play in de-risking emerging technologies and bringing innovative technologies and clean energy solutions to market sooner.

2.1 Interactions with ARENA

By providing grant funding and innovative forms of finance respectively, the combined outcomes of Australian Renewable Energy Agency (ARENA) and the CEFC are key to the development of a more mature and sophisticated clean energy sector in Australia.

IGCC was disappointed with recent decisions to significantly reduce funding available to ARENA. We believe that there is clearly a need for early stage venture capital or grant funding to develop

[2] Road to Return: Institutional Investors and Low Carbon Solutions, IGCC, September 2017 https://igcc.org.au/wp-content/uploads/2017/09/IGCC-road-to-return-final-final.pdf

Australia's pipeline of low carbon and clean energy technologies. Energy technologies are expensive to prove up to a stage where they are commercially investable.

Support from ARENA at the right point in the R&D and pre-commercial development stage is crucial to growing capacity across the sector and can frequently led to projects which subsequently pass through to CEFC investing. The work of both ARENA and CEFC is complementary and ideally interlinked, to support the accelerated entry of cost-effective and innovative technologies reach commercial viability.

Ongoing work remains for these two agencies and should be supported by both public and private sectors to efficiently and effectively allocate the remaining resources appropriated to each of them.

3 How effective has the CEFC been in the evolution of the Australian clean energy sector?

Investors have a unique perspective on many of the issues playing out in the energy debate. Investors are exposed to the financial risks associated with short term policy decisions and look to the longer-term market signals for guidance on capital allocation. All of which have cost implications for investment across the sector when the policy response is fragmented, incomplete or sending contradictory signals to the market.

The impact that the CEFC has had in supporting Australia's clean energy sector is evident in the diverse portfolio of projects that the CEFC has supported to date, with a broad range of finance partners.

The CEFC has provided a crucial source of finance to the clean energy sector through an extended period of national policy uncertainty, through its ability to support continued flows of finance into the sector since its establishment, has provided a 'buffer' for the sector that has allowed the continued development and completion of clean energy projects while energy and climate policy has undergone major transformations at all levels of Government.

This has ensured that essential knowledge and experience within the clean energy sector has remained within Australia during a period of substantive global growth. Maintaining a domestic base of skills, knowledge and capacity is critical to future low carbon economic growth.

The effective de-risking of low-carbon technologies, by supporting project developers and investors to demonstrate and subsequently benefit from projects that can be built at scale owes much to both the existence of the CEFC as a financing mechanism, as well as the operation of the CEFC itself and its clear desire to develop and support innovative projects and investment mechanisms.

However, there remains significant untapped potential for the CEFC to leverage further investment funds and finance for the clean energy sector through increased engagement with institutional investors. As some of the largest managers of investment funds in Australia, and globally, institutional investors have a core role in the wider economy and must be engaged in driving investment in the clean energy sector.

Investor Case Study: Investa Commercial Property Fund
In April 2017, Investa Commercial Property Fund (ICPF) announced a 10-year, $100 million Australian dollar, Green Bond issuance, with a semi-annual, coupon of 4.25% and a maturity of April 21, 2027. The CFEC contributed a corner-stone investment in the bond issuance, with a commitment of $19 million. With the involvement of the CEFC, the bond issuance, which was oversubscribed, has been approved as a 'Certified Climate Bond' by the Climate Bonds Initiative. The ICPF acts as an example of how targeted support for institutional investors can served as a key step towards further development in the investor base for green bonds in the Australian energy sector.

Despite the recent recovery in renewable energy investment, investment from large institutional investors remains nascent. Superannuation funds are long term investors and need to understand the future policy landscape to appropriately price investments or assets held for long durations.

Many of the technologies required for transition to a low carbon economy are also still evolving. Therefore, investment opportunities may not be at a stage or scale that enable long term investors like superannuation funds to obtain the appropriate return for the risk of investing in new technologies.

This includes commercial conditions which may bring an added dimension of issues. Even a vanilla type solar project has detailed due diligence for all aspects, as well as the regulatory risk, market risk, counterparty risk and the commercial contracting components requiring detailed assessment.

However, emerging technologies often find it difficult to secure sufficient finance to support their early adoption and demonstrate their full potential to improve the way we source and consume energy. New technologies carry a degree of risk which creates barriers to investment, through increased financing costs and requirements to deliver returns weighted against this risk.

In working with investors with an active presence within Australia's low-carbon sectors, including investments in energy assets and property assets with low or zero carbon emissions footprints, the CEFC has the potential to further expand the amount of capital available to the sector.

By adapting an investment strategy that aims to attract new sophisticated and institutional investors through partnerships for the formation of climate bonds, the de-risking of emerging technologies and working to support a stable investment environment, the CEFC can leverage greater institutional investment for the clean energy sector.

4 How has the Act enabled the CEFC to efficiently allocate its resources?

The ability for the CEFC to actively identify projects of merit, with the capability to drive further developments and innovation in the clean energy sector, as well as using the most appropriate funding or investment mechanism, has largely been restricted by its ascribed investment mandate, rather than the operation of the CEFC Act itself.

Recent changes to the specified portfolio benchmark returns that must be achieved by the CEFC, have created additional challenges. The investment mandate, and most significantly, the portfolio benchmark return specified in it, greatly informs the investment projects that the CEFC may seek to offer to the clean energy sector as well as the risk profile of the projects subsequently receiving CEFC investment.

The CEFC has to date generated strong and consistent returns from the investments that it has made, and there is no reason why the CEFC could not continue to do so. However, it can be argued that the setting of a high portfolio benchmark return rate would limit the ability of the CEFC in providing finance for projects or supporting the establishment of new funds and climate bonds, that may not have a risk-return in line with the portfolio benchmark return. This creates a greater risk that the CEFC will inadvertently crowd out more mainstream investors, rather than meeting its core mandate.

Some institutional investors have noted that restrictions on the ability of the CEFC to invest in pooled funds with exposure to international holdings has limited the ability to develop joint funds. Greater flexibility on provisions for mixed national and international exposures would potentially facilitate further institutional investor participation.

Greater clarification the application of Section 61 of the CEFC Act, and the subsequent guidelines provided by the CEFC under that section relating to the need for the CEFC to make investments in ‘solely or mainly Australian based’ activities would be beneficial for investors. This is particularly relevant for situations for investors with mixed national and international exposures.

5 Are there any gaps in the scope of the CEFC Act?

Restrictions on the type of projects and kinds of technologies that the CEFC may invest in, by either direct exclusion or by omission, will limit the ability of the CEFC to consider providing investment support for projects that have supplementary benefits and delivering suitable investment returns. Investments in infrastructure, particularly those in physical infrastructure and property, will be motivated by the future impacts of climate change and made to improve the climate resilience of such projects.

The future costs from the impacts of climate change represent a significant risk to investors and the wider Australian community. At present, minimal support exists for investors to proactively invest in climate change adaption and risk mitigation measures. Barriers to finance and investment has been identified as a key barrier to increased resilience across the Australian community.

In April 2017, IGCC published a new report '*Risk to Return: Investing in Climate Change Adaptation*'[3]. Developed through a multi-stakeholder climate adaptation finance consultation process, it aims to identify real world investment barriers and recommend potential solutions, with the goal of enabling the finance sector to access adaptation investment opportunities. It also sets out a pathway forward with specific recommendations.

One key finding from this research was that blended mitigation and adaptation investment solutions have the ability to generate generate commercial return and adaptation outcomes. This could well be the simplest way to harness opportunities blending adaptation with mitigation finance, it is possible to generate return and reduce risks by increasing resilience. This also suits the way that many adaptation projects work, namely that adaptation (or resilience) features are imbedded into project design and difficult to separate.

Investments in adaption measures, both for existing and future infrastructure would work to protect and preserve the value of investments in property and infrastructure. If enabled to make such investments, the CEFC would have significant potential to support investors in identifying and supporting the Australian investment community to incorporate climate resilience into the design and retrofitting of major buildings and infrastructure.

Property and construction companies are themselves leading investment in adaption measures that go beyond existing regulatory requirements, identifying the need to protect their investments in property and infrastructure from future climate risks. These investments in adaptation work to protect and preserve the value of such investments, limiting the potential future impacts on asset values, performance, cash flows and business continuity.

As such, there is the potential for commercial returns to be achieved through long-term investments in adaption measures and the incorporation of climate resilient designs in existing and future property and infrastructure assets. As an emerging market, support from available public finance providers such as the CEFC can provide crucial leverage of private capital while investors and infrastructure managers work to understand the potential future risks of climate change and appropriate adaptation measures.

[3] Risk to Return: Investing in climate change adaptation (2017)
http://www.igcc.org.au/resources/Pictures/Adaptation_FINAL.pdf

As it specifically relates to and expansion of the investment mandate for the CEFC, financing or direct investments in adaption and climate resilience can be made alongside the types of investments currently made in climate mitigation and energy management infrastructure.

Investor Case Study: QIC Global Real Estate
QIC Global Real Estate, with the support of the CEFC, is investing in significant upgrades to some of Australia's largest shopping centres, leading to major reductions in greenhouse gas emissions and improvements in energy efficiency. Leveraging the significant property portfolio of QIC will also ensure the demonstration project delivers tangible reductions in greenhouse gas emissions and energy use, with a commitment to attaining a minimum of 4-start NABERS ratings for all properties within the portfolio and energy savings of up to 40 percent. The project will provide a potential pathway towards reaching zero net emissions from buildings held by the portfolio. Noting the potential for shopping centres across Australia to achieve significant greenhouse gas reductions, the QIC is partnering with the CEFC to provide a demonstration of how investments in on-site renewable energy technologies, energy efficient heating, cooling and lighting systems can reduce emissions while also being a financially attractive investment.

6 Conclusions and recommendations

IGCC believes that the CEFC has played a valuable role since its establishment in supporting the growth of low carbon investment in Australia and has played a central role in the emergence of a more mature and sophisticated clean energy sector.

IGCC supports the ongoing operation of the CEFC.

There are further opportunities to engage with institutional investors in delivering low carbon outcomes and some minor amendments to the CEFC Act and Investment Mandate which would unlock greater participation from institutional investors.

IGCC would be happy to facilitate further discussion with investors on these matters as part of this review.