

AUSTELA

Australian Solar Thermal Energy Association Ltd

14 March 2012

CEFC Secretariat
CEFC Expert Review Panel
By email: cefc@treasury.gov.au
Attention: Mike Waslin

CEFC Engagement in Energy Financial Markets

AUSTELA is the industry body solely devoted to solar thermal power in Australia. Comprised of some of the leading global participants in the solar thermal industry, AUSTELA's role is to:

- assist in the development of an investment environment supportive of solar thermal power development in Australia, and
- promote the development of Australian solar thermal industry capacity

by providing improved access for Australian energy policy and investment decision-makers to the best available information globally about solar thermal power technologies, projects, costs and value.

AUSTELA is strongly supportive of the creation of the CEFC. In AUSTELA's view the CEFC is needed to address key market failures and barriers to investment that are currently slowing, and increasing the cost of, the transition to a low-carbon economy and the achievement of Australia's 2020 RET.

We are aware that submissions in response to the Expert Review Panel's Request for Submissions closed on 8 December.

In the knowledge that the CEFC Expert Panel has received many submissions addressing a wide range of issues. AUSTELA asks in this letter that the Expert Panel consider two brief points:

1. Core objective

The CEFC's core objective should be to assist and drive the acceleration of private sector participation in renewable energy investment.

CEFC should provide, and help to facilitate the development by the private sector of, financial and risk management products and services that help to bring renewable energy technology and project investments within risk parameters that are acceptable to private sector investors and financiers; examples include equity investment and project finance, and loan/capital guarantees that mitigate technology risks (real or perceived) and so widen and deepen the pool of potential private sector investors.

2. CEFC should build a portfolio in energy financial market products

Renewable energy generation assets are relatively capital intensive, with relatively low operations and maintenance costs as they consume no fuel. Renewable generation assets, like other infrastructure assets, have long operating life with a corresponding long amortisation period; they require long-term equity and debt finance and long-term stable revenue streams.

Currently, the structure of Australia's energy markets is such that there is not an effective market for long-term off-take (power purchase) agreements. The failure of energy financial markets to provide products enabling renewable energy projects to secure long-term, stable sales commitments for output is a major and ongoing constraint to private sector investment in clean energy. This is a particular issue for large-scale solar thermal power generation, but applies to any clean energy or renewable energy investment of significant scale.

This market gap can be addressed by CEFC-backed products and services in the energy financial

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markets. A portfolio of such products (or economic exposure to such a portfolio) could provide the CEFC with stable, positive returns over the long term.

CEFC can build in its investment strategy and business plans a component of its investment portfolio based on energy financial market products. These may include swaps, contracts for difference, long-term power purchase agreements, and options, which recognise the long-term value of renewable and clean energy project yields and look beyond near-term cost/revenue shortfalls.

Financial products such as these are not yet available in relation to large scale renewable generation. This is partly because there is no party in the market with a sufficiently strong balance sheet to offer them and the mandate to accept the investment risks they entail.

CEFC will be a strong counter-party in the market and uniquely positioned to manage these risks; energy financial markets products backed by the CEFC would be highly valued by financiers and other market participants and will attract keen pricing as a result, lowering the cost of finance for renewable energy projects overall.

One example of the potential for such a CEFC-backed product is in large-scale solar projects. Solar power typically delivers into the NEM at times of higher pricing - often peak price periods. At these times, the NEM average wholesale price is not a relevant reference price; if a solar thermal plant could bear the merchant risk (that is, could participate on its own in the NEM), it would sell into the market at the prevailing high prices available at time of generation, and realise the value increment. Were a solar thermal plant able to take the merchant risk and sell into the market in this way, it could potentially achieve average revenue much higher than the NEM average.

Currently, the same solar thermal plant has no option but to seek a PPA with a market participant with a significantly strong balance sheet to demonstrate to the solar facility's bankers that a long-term revenue stream is locked in. A threshold issue is whether such PPAs are available at all; in the NEM they typically are not.

But even if such a PPA was available, under current market conditions such a PPA acts as a financial swap much to the disadvantage of the solar plant; the solar plant swaps the high but variable revenue stream attributable to its own production for a fixed and much lower revenue stream paid under the PPA. The solar plant, with few or no options with which to extract price leverage, forgoes to the PPA provider most of the profit margin the solar plant would have made over the long term. The PPA provider hedges the swap risk at a low cost - in the wholesale market and/or using its own generation capacity.

CEFC could offer a financial product to solar power developers under which CEFC and the solar plant would more equitably share the revenue increment associated with solar's ability to supply power for peak demand - they would share in the high value of the solar plant's output.

Another example is the contract for difference feed-in-tariff being implemented in the United Kingdom to address market failures very similar to those the Australian markets are exhibiting. This 'CFD FiT' acts as a revenue top-up to a renewable project today, made in exchange for the owners of the renewable generation asset forgoing part of the higher revenues that will be earned in the market in years to come - it provides long-term revenue stability at a reasonable cost.

Whether CEFC itself acts as an originator of such energy financial market products, or acts only as the counter-party risk provider standing behind such products (and contracting out the relevant operations) is a risk management and commercial issue for resolution; there are many financial services organisations in Australia with the capability to provide such product origination and operational services.

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CEFC could choose to underwrite establishment of a fund for this purpose, leveraging CEFC funds by seeking co-investment from the private sector, which could quarantine and limit risks.

AUSTELA urges the Expert Panel to consider, as a key element of the CEFC's investment mandate and commercial remit, how the CEFC can help facilitate greater energy financial markets innovation to accelerate delivery of solutions to address the evident structural failures in the PPA market.

The lack of products enabling renewable energy projects to secure long-term, stable revenue streams against which finance can be raised is and will continue to be a major constraint to clean energy investment in Australia, unless addressed. CEFC has a vital role to support and drive energy financial market innovation to fill these gaps.

Yours sincerely



Andrew Want
Chair, AUSTELA