Briefing paper: Rates-based financing

Overview

One of the key barriers to uptake of new energy technologies by low-income customers is the high up-front cost. To overcome this issue a range of organisations are developing finance products and mechanisms that enable the customer to pay back the cost over a period of time. One of these finance mechanisms is rates-based financing, whereby a council enables finance for clean energy measures on a property and then levies a special rate on said property to payback the cost of finance over time.

Rates-financing can be coupled with local government or other clean energy programs targeting particular customer segments, such as low-income households that overcome additional information and trust barriers that can hinder clean energy uptake.

This briefing paper outlines the role that rates-based financing can play in increasing clean energy accessibility and affordability in Australia and what state and local governments need to do to enable it. Specific policy measures proposed include:

- State government legislative change to allow local governments to levy special charges (rates) for clean energy or undertake EUAs on residential buildings.
- Support for the aggregation of finance at sufficiently low cost of capital that low-income participants are better off from day one.
- Accompanying measures that make rates-financing programs easy for councils, clean energy businesses and households.

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Description of rates-based financing

Repayment through rates or *rates-based financing* for clean energy is where finance for new energy technologies is mediated through the Local Government, with the repayment occurring through a special charge or rate levied on the property and paid by the occupant through normal rate repayments. Usually (though not always), the finance is not local government money, but is sourced through an external financer. Rates-financing can theoretically be used to support any property undertake clean energy or environmental upgrades. However, given the growing number of finance products available through more traditional sources e.g. banks, we suggest that rates-financing is most useful for households that face significant barriers (market failures) to accessing clean energy i.e. low-income households and potentially renters and their landlords.

Status of rates-based financing in Australia

The main form of rates-based financing currently being pursued in Australia is Environmental

Upgrade Agreements (EUAs) for commercial buildings. EUAs are allowed under special amendments to the Local Government Act in both NSW, South Australia and Victoria. However, so far there have only been a few uses of the mechanism (seven in Victoria and five in NSW).

Internationally, rates-based financing for both commercial and residential properties is the basis for a number of successful clean energy programs, with schemes in the US - Property Assessed Clean Energy (PACE), Canada and New Zealand - Voluntary Targeted Rates (VTR). Currently, rates-based financing for residential clean energy is allowed in Victoria under the special charges provision of the Local Government Act, but not allowed under NSW legislation and is unlikely to be allowed in other states either. Further, the special charges provision in the Victorian Act is not necessarily the best legal mechanism, as unlike EUA provisions, it does not allow councils to simply act as intermediaries for finance between a provider and a household/property. Thus, any finance for a clean energy rates-financing program, will set on a council's books, which in turn becomes a barrier to uptake for most councils.

One of the benefits of EUAs in the commercial sector is that it helps address the landlord-tenant split incentive issue. This is not the case at the residential level. Indeed, rates-financing is generally most appropriate currently for owner-occupiers, as state residential tenancy legislation generally prohibits landlords passing on rates to tenants. Changes could be made to the Residential Tenancy Acts to allow an opt-in clean energy rate pass-through, however careful consideration must be given to consumer protection issues before embarking on such changes.

The NSW Office of Environment and Heritage (OEH) are currently investigating residential rates-based financing for clean energy and Queensland is investigating commercial EUAs.

Examples

Darebin Solar Savers, Victoria is a program developed by Darebin City Council. The program in its first year saw the installation of solar PV on 300 low-income households in the City of Darebin. The cost to these households as free up-front, with repayment occurring over 10 years through a special rate/charge; the solar PV system was scaled to ensure households were better-off (through lower electricity bills) from day one. The Council partnered with Moreland Energy Foundation and Energy Matters (now Sun Edison) to deliver the program.

Only pensioners who owned their home and were eligible for the existing rates discount were eligible for the scheme. Darebin Council used its own capital reserves to finance the project at a 0% interest rate due to the fact that it was both a climate and social justice program.

Voluntary Targeted Rates, New Zealand is a program that was first developed by Wellington Council at the request of the New Zealand Government. The NZ Government was running an energy efficiency and health program, with 50% capital grants for clean thermal upgrades, however the program wasn't reaching the most vulnerable households. Wellington Council filled the gap and were able to use a rates mechanism to finance the remaining 50%, at zero cost to the household upfront. Now rates-based financing has been used for residential clean energy (solar, clean heating and other energy efficiency measures) upgrades in over 24,000 homes, with councils covering 60% of the population offering the scheme. Councils are supported by the National Government's Energy Efficiency and Conservation Authority, who provide a toolkit and training, as well as quality assurance audits of 5% of installations completed under rates-financing.

Why rates-based financing?

One of the benefits of a rates-financing approach is that because the repayment it tied to a local government rate, it becomes a statutory requirement for the property against which it is leveraged. As local government debt gets first recall at point of sale, it becomes a much lower risk venture for financiers, thus lowering the cost of capital. Furthermore, because the rate is tied to the property it overcomes longer payback periods associated with more capital-intensive clean energy technologies and upgrades. However, one of the challenges is setting up the scheme by local government – it is not core business and thus requires determination and support to work through the complexity of setting up a rates-based finance scheme.

To summarise, the key benefits for rates-financing particularly compared to conventional commercial solar leases, PPAs and loans are:

- Debt is tied to the property not to the owner, which reduces the payback period risk for the borrower and as such this allows the council to recover debt with accrued interest when the property is sold or it can be passed on to the new property owner;
- Security of the financing attached to the property and statutory rate repayment mechanism, thus it makes it simple for the customer, reduces the risk of default, the enabling a lower cost of capital, due to security of the loan.
- Consumer confidence due to council involvement.
- Can easily be coupled with other clean energy programs including bulk-buys, panel tenders, grants etc as a financing option that makes clean energy more accessible, affordable and easy for consumers.
- Helps make clean energy accessible to low-income households, particularly owner-occupiers.
- Helps meet council environmental, climate and social objectives.
- Can be made cost-neutral for councils.
- The purchase and installation of the solar systems and energy efficiency measures are not subject to GST, because the rates charge is GST exempt, translating to greater savings for householders; and

Making rates-based financing work – specific policy asks

State governments should proactively develop a rates-financing program for residential clean energy targeted at low-income households. This program should encompass:

- State government **legislative change** (typically the Local Government Act) to allow local governments to levy special charges (rates) for clean energy or undertake EUAs on residential buildings. This legislation should allow finance for the program to be off-book for councils.
- Support for the **aggregation of finance at sufficiently low cost of capital** that low-income participants are better-off from day one,

- Accompanying measures that **make it easy for councils, clean energy businesses and households** to be able use the rates-finance mechanism. Such measures should include:
    - Supporting promotion, including information provision and special site-assessments for the target audience that is tailored to said audience
    - Clarifying the scope of clean energy products and services enabled under rates financing
    - A toolkit to help streamline the council administration
    - Matching grants
    - Working with councils to clarify all of the risk and consumer protection issues
    - Underwriting of the finance by state government for rates-finance provided to the most vulnerable customers.
    - A quality assurance process similar to the New Zealand Voluntary Targeted Rates scheme.

Contact details and further information

For more information please contact:

Nicky Ison, Founding Director, Community Power Agency
M: 0402 0345 80, E: nicky@cpagency.org.au

Manny Pasqualini, Community Power Agency. M: 0430 600 303 / E: manny@cpagency.org.au