CENTRE FOR
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TOITŪ TAHUA

Novel Financing Solutions: Industrial Fuel Switching

Blended finance options to accelerate private sector financing.

November 2025

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Context

CSF is advancing novel financing solutions that unlock private capital for New Zealand's energy transition and energy prosperity. As part of this, we are exploring prioritised solutions that target industrial reticulated gas users, to support facilitation of transition to alternative technology solutions where greater security of supply exists, for example electrode or biomass boilers. Industrial businesses using gas for energy purposes consumed ~36% of gas in New Zealand in 2024[1], with electricity generation and non-energy use accounting for most of the rest.

The worsening gas supply shortage is creating energy security and energy equity pressures for businesses powered by gas — pressures that could soon become existential. Supporting businesses to fuel switch will prevent deindustrialisation; safeguard jobs, strengthen communities, and support regional growth. Moving fossil-fueled activity to electricity (or low-carbon alternatives) also delivers significant decarbonisation benefits, given New Zealand's already highly renewable electricity system. At the same time, increasing demand for electricity and biomass will send strong investment signals to renewables developers as well as the biomass supply chain industry, stimulating growth.

Considering this, the proposal in this paper aligns with the following government priorities: building better markets for secure and affordable energy, going for growth and doubling the value of exports, accelerating wood energy as an energy resource, meeting national climate objectives.

Around 500 in-scope sites use gas for (largely) low- and medium-temperature process heat — for which viable commercial alternatives already exist. We are working with EECA and other key stakeholders to understand the overall investment requirement; an early estimation has this at ~$5bn. Work will continue to refine this figure, as well as build a picture of geographic requirements[2].

Transition activity is taking place, it is just that this is not at the scale and pace required. Five key interrelated barrier themes are preventing acceleration.

A. The need for a clear government strategy and investment signals to encourage the flow of private capital.
B. The marginal economic upside and long payback periods associated with fuel switching projects vs. the status quo. While this is often an accurate assessment based on current funding options and energy pricing, the go-forward counterfactual is often not fully represented, especially over the longer term (i.e. future low gas accessibility and / or potentially significantly increased gas prices). In this context,

[1] Energy in New Zealand 2025, MBIE
[2] Note, all reticulated gas users are based in the North Island

investments are required to avoid future cost increases rather than to grow the bottom line.

C. Investment requirements can be substantial, with the subdued economic environment creating uncertainty. Long project payback periods may mean that funding terms for credit do not match the extended timeframe for cost recovery and for any financial benefits to accrue. This can limit appetite for businesses to fund projects as well as making credit applications more challenging for banks to support at an efficient price.
D. The size of project available in New Zealand can shut out attractive capital pools (e.g. institutional investors). Even for NZ lenders, mid-sized projects with increased complexity can make it financially impractical to justify the transaction costs involved.
E. Businesses aren't obtaining all required decision-critical Information or sufficiently accessing the technical expertise to enable informed decisions.

We believe that a government supported financing solution would be catalytic in overcoming barriers A, B, C & D. By providing financial support in the form of a crown guarantee to support private sector lending, direct debt contribution, or a combination of both, the government can crowd-in private capital to facilitate fuel switching and avoid deindustrialisation. Accelerated activity can also help speed up market maturity and bring down transaction costs. Whilst the final barrier (E) cannot be overcome through a financial solution, raising awareness of and enabling access to relevant technical consultants as part of, or parallel to, a wider 'campaign' can help to overcome this barrier simultaneously.

Prioritised Options

CSF is exploring financial solution options; all aimed at enabling the private sector to finance fuel switching projects at greater scale and speed to secure the future of gas using businesses.

There are two key considerations with regards to solution design. These are detailed at a high level below, however we will provide a fuller comparison as part of the next phase of the project.

1. How should any financial solution leverage public capital to maximise impact;
2. How should any solution be implemented for maximum effectiveness and efficiency.

How should any financial solution leverage public capital to maximise impact

There are broadly four options here: no public capital, provision of grants, provision of loans, provision of debt guarantees. There are trade-offs to consider across each; noting our initial recommendation for either loans or debt guarantees we have focussed on these mechanisms only in this paper.

1. Provision of loans

The proposal under this approach would combine a minimum level of debt from the private sector (e.g. 80% of project debt) with a lending contribution from the government (e.g. max 20%). Government debt would be provided at 0% or a low fixed interest rate, with long tenors and flexible amortisation profiles available (e.g. up to 10 years with no capital repaid until year 7, private sector tranches would likely be structured on a shorter, more 'vanilla' basis). The objective of this approach would be to enable longer term borrowing, drive a lower cost of capital, and better match repayments to forecast cashflows, all of which would supports overall project economics. A primary trade off would be the requirement for up front public capital.

2. Provision of debt guarantees

Under this proposal, the private sector provide 100% of the debt, with the government guaranteeing (e.g.) 75% of total project debt. This would result in a lower cost of capital for banks that can be passed through to businesses via lower interest rates, supporting project economics. It would also support to cover a risk gap, where funding requirements are substantial relative to business size. Guarantees are less effective at enabling long-term financing cost certainty and matching repayments to cashflow, however, this option doesn't tie up public capital to the same extent as lending public money directly, and as such is more fiscally efficient.

This approach would also replicate a proven model: the Business Finance Guarantee Scheme (BFGS) under the COVID response, the North Island Weather Event Scheme (Cyclone Gabrielle response) and the incoming Community Housing Initiative. All the main banks have participated or are participating in these schemes, with good understanding of loss rates. Claims have been very modest compared to the funding facilitated.

How should any solution be implemented for maximum effectiveness and efficiency

There are broadly two options for consideration: administering the scheme through the private sector, similar to the BFGS, or establishing a dedicated fund into which lenders (and potentially government) can place capital. Our current view is that administering the scheme via the private sector is the recommended approach.

1. Administer through the private sector

Leveraging the private sector for origination, due diligence and credit processes avoids the need to establish these, removing a significant amount of time and cost. Clearly established criteria, which will be required regardless of approach, will enable the private sector to alter existing processes as required, and previous schemes (such as BFGS) can be reviewed to identify process efficiencies.

2. Create a specific purpose fund

Whilst there are additional costs and complexities associated with the creation of a fund, the major upside is the ability to attract capital from a wider pool, such as institutional investors, assuming ticket sizes are significant enough. This has the potential to reduce the borrower cost of capital and better match financing costs with project payback periods. This is not currently viewed as significant enough a benefit to outweigh the benefits associated with option 1.

Related Activity

CSF is engaged with the energy industry led Energy Transition Framework, through its workstream looking at how finance can help businesses to switch to electric alternatives. This work brings together industry participants, from generators to retailers, lines and distribution companies, and independent consumer and advisory representatives, to overcome finance-related barriers to C&I electrification. It is being progressed under four workstreams: investment viability; price and revenue uncertainty; finance market gaps; and network and connection costs and risks.

Engagement with the ETF will ensure appropriate visibility of any finance solution taken forward, and will help enable suitable alignment with other areas of challenge where applicable e.g. Electricity Networks Aotearoa work to explore alternative financing options for EDBs to facilitate acceleration of grid investment.

Approach to Eligibility

The list of in-scope sites, which account for roughly 65% of C&I gas use today, is based on EECAs RETA data, using the following criteria:

- Is a reticulated gas user.
- Has greater than 500 kW installed fossil fuelled stationary heat capacity.
- No current confirmed transition project.

(note: Methanex and Balance Kapuni sites are excluded)

We propose that eligibility criteria are kept as simple as possible to avoid lengthy / costly deal level processes. While this will result in marginal exclusions (e.g. where a site has ~480kW installed fossil fuelled stationary heat capacity) we see this approach as necessary to maintain simplicity, as well as enable more accurate sizing for the requirement for financial support. Whilst eligibility will be strict, it should be noted that the benefits of the proposal extend beyond the businesses, employees and communities where financial support is received. The preservation of gas will positively impact availability and price for remaining gas users, whilst the acceleration of market familiarity should drive down related costs for other businesses and projects in the future, overcoming the project complexity issue highlighted in barrier D.

We also considered assessing the “transition readiness” of the in-scope sites, with a view to targeting only the most transition ready sites initially. However, we feel that the potential subjectivity and complication that this could bring to the process would be counterproductive. Noting the precarious nature of current and future gas supply levels, injecting urgency into the whole ecosystem is seen as a positive outcome.

It is noted that transition of the whole economy will happen over a long-term timeframe. However, the proposal in this paper specifically targets the acute deindustrialisation challenge of the near-term. Considering this, government financial support would be available for a specified term (e.g. for any applications submitted within [3] years). From the government we would request a commitment to support a proportion of the full in-scope cohort. This would be calculated based on assumptions regarding the number of long-term commercially viable businesses that the private sector would be willing to support on a BAU basis under normal market conditions.

Approach to Government Support

Calibrating the appropriate level of the financial support provided by the government is a crucial element of solution design. Support must be sufficiently catalytic yet minimised to ensure most effective use of public money.

Noting this, we expect to recommend that a tiered approach to financial support is used, to achieve the optimal balance between scheme efficiency / simplicity and right-sizing the level of government support for each project. In practice, the level of support would reduce as size of business increases, based on the working assumption that larger businesses have more adequate resources and access to capital to undertake fuel switching. We would also propose to explore a cap, whereby businesses above a certain size threshold would be ineligible for the scheme. This approach mitigates the proposal against potential accusations relating to corporate subsidies.

Next Steps

We aim to submit a proposal with recommendation, following the Treasury Better Business Case methodology, for ministerial review by year-end.

We acknowledge that any approach would need to include appropriate upfront and ongoing control mechanisms. We view this as largely unavoidable if government support is present. We are not yet seeking feedback on how any support should be appropriately managed and reported from this perspective.

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Contact Andy O'Hare (andy@sustainablefinance.nz) with any questions or to request further information on the content of this report.