

# Clean Energy Bond Finance Model

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## Qualified 501(c)(3) Bonds

### Full Description

Qualified 501(c)(3) bonds provide tax-exempt financing to certain nonprofit organizations—typically hospitals and schools—to carry out capital improvements. This type of bond financing is available to any community with bond issuing authority and partnering qualified 501(c)(3) organizations seeking to undertake allowable projects.

501(c)(3) bonds have been used by the development finance community for decades to finance capital expenditures, which can include land, buildings, equipment, and related infrastructure. For some organizations, the bonds may also be used to refinance prior debt, reimburse prior capital expenditures, or provide working capital. After issuance, the bonds are paid back through revenues generated by the borrowing entity.

Through the federal tax-exemption, 501(c)(3) bonds feature lower interest rates for the borrowing organization while compensating the rate difference to investors through lower federal income taxes. Bond financing can allow an organization to complete an eligible project sooner, at a larger scale, and with more favorable terms than would be feasible through capital fundraising efforts or other financing tools. Financing large projects through 501(c)(3) bonds also frees up cash flow in the short term to serve other purposes, providing the borrower greater flexibility in financing its operations.

As with any tax-exempt bond, an eligible issuer (such as a state or local government entity) will structure a 501(c)(3) bond project in concert with a financial advisor and the borrowing organization. Bond proceeds are held with a third-party bank trustee until the completion of the bond sale. The issuer sells bonds to an underwriter, to be resold to individual investors in the tax-exempt market. Bond proceeds are then loaned to the nonprofit borrower, with disbursements and debt service administered by the trustee. 501(c)(3) bonds must follow IRS guidelines for other Private Activity Bonds regarding TEFRA, public approvals and other requirements.

501(c)(3) bonds can be used to provide nonprofit facilities with deep energy efficiency or renewable energy installations. Clean energy improvements can be a component of a larger project. For example, a headquarters building could be expanded and the older portion of the building could be retrofit at the same time. Projects can also be conducted on a stand-alone basis.

In order to improve the efficiency of this capital source, multiple nonprofit facilities or organizations can be pooled together in a single issuance. A university could update several campus buildings in one project. An affiliation of charter schools could be brought together by a single issuer. Whether combining multiple improvements to a single, large facility or pooling retrofit projects among several nonprofit-owned facilities, 501(c)(3) bonds can scale clean energy investments to a considerable degree.

The activities supported by clean energy-focused 501(c)(3) bonds would go great lengths to grow robust clean energy infrastructure among eligible nonprofit organizations. The flexibility and established investment reputation of this financing tool will encourage the spread of retrofits, installation of renewable energy infrastructure, reduce energy expenditures among donation-dependent nonprofits, and contribute to state and nonprofit clean energy goals. This potential makes 501(c)(3) bonds a recommended clean energy finance model for states and municipalities to consider.

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### Summary Description

501(c)(3) bonds are financing vehicles for nonprofit organizations seeking to make facility improvements and capital expenditures. The bond is issued by a government entity to provide long-term, low-cost capital for large clean energy projects. 501(c)(3) issuances for energy efficiency or renewable energy projects mirror issuances for other eligible capital expenditure projects.

### Model Profile

<b>Model Type:</b>	Tax-Exempt Bond	<b>Energy Type:</b>	Renewables or Efficiency
<b>Bond Type:</b>	Revenue Bond	<b>Applying Entity:</b>	State, Local, or Regional Issuer

### Model Benefits

- **Cost of Capital** – Tax-exempt bonds offer borrowers exceptionally low interest rates over extended periods of time, making marginal projects financially feasible.
- **Existing Investment Class** – 501(c)(3) bonds are a familiar product to institutional investors, ensuring a market of buyers for quality issuances.
- **Access to Large Amounts of Capital** – Through combining multiple energy-related improvements into one project or pooling improvement projects across multiple facilities (such as a network of charter schools), 501(c)(3) bonds can be used to finance deep retrofits or clean energy installations of nonprofit facilities, creating a significant impact on local energy consumption.
- **Large Pool of Prospective Projects** – School and nonprofit facilities are common in all regions of the United States. Both new buildings and older facilities stand to benefit from clean energy improvements that reduce monthly energy expenditures.
- **Revenue Generation** – Rather than relying on public funds to service debt, as in the case of general obligation bonds, 501(c)(3) bonds are repaid by revenues of the nonprofit borrower. Cost savings on utility bills may free sufficient revenues to support a significant piece of the payments.

### Model Shortcomings

- **Project Size** – 501(c)(3) bonds are ideal for larger projects, and offer little cost benefit to smaller projects due to the administrative costs associated with structuring bond transactions.
- **Revenue Requirements** – Nonprofits must demonstrate strong potential for future revenue to service bond debt. Private, detailed assessments would need to be conducted to ensure the cost savings would support repayment of such an investment. Furthermore, on-bill repayment models are relatively new concepts with few programs that have reached the end of a portfolio loan life cycle.

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### Model Applications

- **Chicago, IL** – Loyola University, Lake Shore and Water Tower Campuses financed multiple projects with 501(c)(3) bonds issued through the Illinois Finance Authority. The campuses installed several advanced energy saving features.
- **Elmhurst, IL** – Elmhurst College utilized \$25M in 501(c)(3) bonds to finance a student housing facility and adjacent surface parking lot. The facility achieved LEED Silver Certification.
- **Washington, D.C.** – The World Wildlife Fund (WWF) utilized the District of Columbia's 501(c)(3) bond program to finance the construction of their 'Green Headquarters'. The WWF Green Headquarters incorporated significant energy efficiency measures and received LEED EB Platinum Certification in 2011.

### Locations / Projects that Could Apply the Model

501(c)(3) bonds are already used by authorities throughout the nation to provide nonprofit organizations with necessary financing for capital expenditures. Any location with a knowledgeable state or local issuer will be able to assist a nonprofit organization in taking advantage of this model. The best candidates for this model will be 501(c)(3) organizations with an established reputation, solid prospects for future revenue, a strong credit rating, and significant real estate holdings.

### Potential Modifications to the Model

- Form partnerships to provide technical assessment services as part of the financing project.
- Provide credit enhancements to allow for more labor-intensive improvements with little collateral value.
- Forecast energy savings with a goal of approaching net bill neutrality prior to approval.
- Pool several, smaller projects into one issuance to limit issuance costs for all borrowers.
- Pair 501(c)(3) issuances with tools such as credit enhancement, tax credits, grants, etc.

### Items for Further Research / Development

- Does net bill neutrality in large scale projects (energy cost savings equal to or greater than monthly debt service) act as an acceptable credit enhancement?
- What is the potential for collaboration among issuers to finance large-scale projects across a wide geographical area?

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## Qualified 501(c)(3) Bonds

### Additional Resources

Council of Development Finance Agencies – Stern Brothers & Co. – 501(c)(3) Bonds:

<http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=reisnerbonds.html>

Economic Development Corporation of Oakland County – Factsheet for Nonprofits:

<http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=edcoc-501c3.html>

Ice Miller LLP – Fundamentals of Tax-Exempt Financing for 501(c)(3) Organizations:

<http://www.icemiller.com/publications/30/787557.htm>

Internal Revenue Service – Tax Exempt Bonds for Charitable Organizations:

<http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=irs501c3.html>

Kutak Rock LLP – Pools and Religiously Affiliated Financings:

<http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=ray2005ac.html>

Orrick, Herrington, and Sutcliffe LLP – Borrowing with Tax-Exempt Bonds:

<http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=OrrickNonprofitTaxExempt.html>

Illinois Finance Authority – Energy Solutions Workshop: Financing Options for IL Businesses and Institutions:

<http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=ifa-energyworkshop-200814.html>

World Wildlife Fund: Taking Care of its Own:

[http://www.cdfa.net/cdfa/cdfaweb.nsf/0/6B59A207F4D5BE4E88257CC40067E630/\\$file/WWF\\_article.pdf](http://www.cdfa.net/cdfa/cdfaweb.nsf/0/6B59A207F4D5BE4E88257CC40067E630/$file/WWF_article.pdf)

### For More Information

**About Clean Energy + Bond Finance Initiative (CE+BFI):** CE+BFI, created by CEG and CDFA, is working with finance and energy professionals across the country to find ways to increase clean energy investment by an additional \$5 billion to \$20 billion in the next five years. For more information, visit: [www.cleanenergybondfinance.org](http://www.cleanenergybondfinance.org).

**About Clean Energy Group (CEG):** CEG is a leading national, non-profit advocacy organization working in the U.S. and internationally on innovative technology, finance, and policy programs in the areas of clean energy and climate change. For more information, see [www.cleanegroup.org](http://www.cleanegroup.org).

**About the Council of Development Finance Agencies (CDFA):** CDFA is a national association dedicated to the advancement of development finance concerns and interests. CDFA is comprised of the nation's leading and most knowledgeable members of the development finance community. For more information, visit [www.cdfa.net](http://www.cdfa.net).

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