Clean Energy Bond Finance Policy Proposal

STATE CLEAN ENERGY FINANCE INITIATIVE

Leveraging Private Financing for Clean Energy Development

Much of the dramatic growth of the clean energy industry over the past 15 years has relied on the provision of grants, incentives, rebates, policy initiatives and technical support from state clean energy programs. But continued growth will be limited as long as it relies primarily on deep public subsidy. What will be needed going forward is a more integrated approach, one that continues the important public role of providing incentives and technical support for the adoption of clean energy technologies, at the same time it provides public financial support in the form of credit enhancement to leverage more private capital. Public subsidy needs to advance in its approach and performance, becoming better at "right-sizing" its subsidy based upon better information, disclosure and understanding of evolving clean energy project economics. Efficient public incentives need to be better integrated with public credit support programs that induce more private capital investment. This integrated approach will allow clean energy companies and projects to achieve greater scale and tap into capital markets.

State Clean Energy Finance Initiative at a Glance:

- State Clean Energy Finance Initiative designed to assist clean energy industry in accessing affordable capital.
- Initiative, housed at the U.S. Dept. of the Treasury, would apply federal support for clean energy development through state-operated financing programs.
- State Clean Energy Finance Initiative would emphasize bond finance, the primary financing vehicle for American infrastructure, for clean energy development.
- Program models receiving support from the Initiative would be loan loss and debt service reserves, letters of credit, loan guarantees, collateral support, and subordinated debt.
- Objective of state programs supported by the Initiative would be to achieve a leverage ratio of $10 in private investment for every $1 of federal contributions to state programs.
- Recommended State Clean Energy Finance Initiative capitalization is $5 billion to leverage $50 billion in private clean energy investment.

Public programs that leverage private investment cannot be created in a vacuum. Clearly, access to private capital on commercially reasonable terms is necessary to accelerate the clean energy investment. However, commercial banks are now faced with much greater credit oversight than in the recent past, and have consequently tightened their credit standards as they have regrouped in the aftermath of the Great Recession of 2008. Concerns regarding the adequacy of collateral, borrowers' debt capacity and the need for debt service and loan loss reserves have resulted in many borderline commercial loans not being made.

Acutely aware of this, there is a now a strong interest at the state level in finding ways to use public clean energy dollars to provide credit enhancement that attracts private investment to finance clean energy at significant scale. States want to make sure that their incentive dollars are structured efficiently to leverage the greatest amount of investment; at the same time, states want underwriting and credit enhancement decisions to remain at the local, not the federal, level.

Recognizing the need to significantly increase the availability of credit to small businesses during the recession, the U.S. Department of the Treasury created a program to expand state programs that provided credit enhancement to private lenders and investors for small business finance. It is this model – the State Small Business Credit Initiative – that could now be applied to the clean energy sector to efficiently leverage public dollars with private investment.

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An Innovative Federal Financing Model

The State Small Business Credit Initiative (SSBCI) was passed by Congress as part of the Small Business Jobs Act of 2010. The legislation provides the U.S. Department of the Treasury (Treasury) with $1.5 billion to bolster state programs supporting small business lending. Under this innovative delivery mechanism, the federal funds are applied through programs of the states' choosing, although Treasury must approve program designs. The ultimate goal of the program is to leverage billions of dollars in private lending alongside the public funding.

Program Requirements

The general goal of the SSBCI is to facilitate small business lending by making private financial institutions comfortable making loans to almost credit-worthy small businesses. The program requirements reflect this objective. States, including all territories and municipalities in non-participating states, submitted small business lending support programs to the Treasury for review. Eligible programs are required to never protect more than 80% of a loan and to achieve a minimum 1:1 ratio of private-to-public lending. Loans are required to go to small businesses, which are defined as 500 (or 750) or fewer employees, and loan sizes are also restricted to $5 million (or $20 million) or less.

The SSBCI legislation encourages specific small business lending program models. These are capital access programs (CAPs), loan participation programs, loan guarantee programs, collateral support programs, and venture capital. States are allowed to use SSBCI funds to support one or more programs, and funds can be used to capitalize new programs or to bolster existing ones. Through the program approval process, the states and Treasury work together to select the right mix of small business lending programs to fit the capital needs of the state, the capacity of the applying organization, and the requirements of the federal legislation and guidance.

Program Review

The SSBCI is an innovative delivery model for federal economic development assistance to the states. By allowing states to submit a package of programs to Treasury for approval, states retain a much higher degree of autonomy than is typical with federal programs and are better able to address the small business capital access needs in each state. This model has also faced challenges in its first iteration. The home rule approach led to Treasury's approval of more than 140 individual program designs, creating severe federal administrative burden and effectively preventing participation from regional and national lenders. States have also struggled to implement programs effectively—or, at least, to implement the programs on the scale necessary to support $1.5 billion of public and an additional $15 billion of private lending over a five year period.

There are clear benefits to the State Small Business Credit Initiative model of federal assistance, but there are also clear lessons that could make future programs even stronger.

An Opportunity to Leverage Clean Energy Private Investment

The SSBCI model should be extended to help address the capital access challenges confronting clean energy. Establishing a financing-based model to bolster this sector would encourage the development of clean energy at a time when direct appropriations to the industry are facing increased pressure. An SSBCI-like model should be applied

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to clean energy supply chain companies needing financing for working capital, equipment, real estate acquisition or improvements to their business premises, as well as to project financings of on-site and district clean energy generation limited to eligible technologies, size limitations, and capital requirements.

State Clean Energy Finance Initiative

This "State Clean Energy Finance Initiative," modeled on the SSBCI, would be an efficient means of attracting significant private investment to clean energy. This Initiative would also be housed in Treasury. However, the underwriting and credit enhancement roles would be placed at the state and local levels where these roles belong. Treasury would develop guidelines defining various structuring factors to a manageable toolbox of program structures, and Treasury would approve each state's clean energy credit support programs. Each state would have the right to select only the programs that the state wants to operate.

The State Clean Energy Finance Initiative would also target a 1:10 leverage ratio of public-to-private investment. In the instances where the Initiative's programs may not provide enough confidence to private lenders and investors to participate in a transaction, the programs can serve as a strong incentive to state clean energy funds to provide additional matching credit enhancement as well.

The original SSBCI Act specifically referenced the intended participation of U.S. Treasury-certified Community Development Financial Institutions (CDFIs), and they should be included again in the proposed clean energy program. CDFIs are flexible, CARS-rated financial institutions with their own extensive bank and investor relationships that can be drawn upon to meet the model's 1:10 leverage requirement.

Energy Bond Finance Programs

In order to effectively address the credit challenges of the clean energy industry, the State Clean Energy Finance Initiative would include a slightly different mix of programs than those found in the SSBCI. Venture capital and capital access programs, included in the original SSBCI legislation, would not be eligible under the proposed program. Each of the designated types of credit support programs—loan loss and debt service reserves, letters of credit, loan guarantees, collateral support, and subordinated debt—are important and familiar roles for development agencies to play and do not result in heavy administrative or loan servicing burdens.

The proposed State Clean Energy Finance Initiative would fund credit enhancement tools providing credit support for bond finance structures, such as pooled bond funds and small issue bonds for manufacturers in the clean energy supply chain. By mitigating risk for investors, credit enhancement would raise more capital more efficiently at lower cost to multiple energy projects.

There are various forms that this credit enhancement might take:

- *Loan loss and debt service reserves.* Program funds could be structured as loan loss reserves that would be available to protect investors from losses arising from individual non-performing assets, including those within a bond pool. Similarly, the proposed program could fund the debt service reserves required by bond covenants, freeing up bond proceeds for other purposes or reducing the size of the issuance and debt service burden.

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- *Letters of credit.* Program funds could support bank letters of credit that protect investors from losses. Letters of credit are a common form of credit enhancement for private activity bonds, and would be effective in raising tax exempt and taxable bond financing for energy projects without each bond pool transaction having to be rated by a credit rating agency.

- *Guarantees.* Program funds could provide support for a state fund or agency's guaranty of a bond pool, ensuring repayment to investors if there is a payment default from the underlying assets.

- *Collateral support.* Program funds could support borrowers with insufficient collateral by creating a cash deposit at a financial institution to serve as additional borrower collateral.

- *Subordinated debt.* A state fund or agency could use program funds to purchase a portion of a bond issuance, repayment of which is subordinated to the payment of the other bondholders.

By appropriating $5 billion in funding for clean energy credit support, the proposed program could leverage an additional $50 billion of private and other capital for companies and projects in every state in the nation, requiring little if any additional federal administrative burden.

For More Information

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