Using Financing to Serve the UnderServed

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Goal for Presentation

- To describe what tools are available to a state energy office to *use* or *encourage* financing that supports clean energy for hard-to-reach customers.
- To describe how those tools might be used by state energy offices with differing resources available to them.

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Defining the “UnderServed”

- UnderServed markets are markets that traditional financing providers and products fail to reach, or fail to serve with attractive financing. Examples include:
  - Residential low-moderate income for single family
  - Residential low-moderate income for multi-family
  - Commercial businesses that do not show a profit, that have < 2 years history
  - Commercial business in disadvantaged communities
  - Sub-sectors of the MUSH market (small school districts, rural areas)

Why are Markets Underserved by Private Capital?

- Transaction costs overwhelm small deal sizes
- Credit quality is poor or non-existent
- Credit quality is not well understood
- Geographic areas that are not well-served

Why are UnderServed markets an opportunity for public entities?

- UnderServed markets represent an opportunity for governments to serve broader policy goals (rural economic development, support to LMI populations etc.)
- UnderServed markets represent an opportunity if governments have better quality information than is available to the private sector about clean energy markets
- UnderServed markets are an opportunity to deploy more flexible capital often available to governments – public entities can be much more flexible about yield requirements

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What Tools Do Governments Have Available?

- Do you have capital available to deploy?
  - Direct lending (revolving loan funds)
  - Assume risks in order to attract private capital (credit enhancements)
    - Loss reserves
    - Debt service reserves
    - Loan participations
- No capital to deploy?
  - Partner with community development lenders
  - Partner with housing authorities
  - Partner directly with financial institutions

Direct Lending (RLFs)

- Example: Colorado, Wisconsin manufacturing and clean energy loan programs.
- Definition: Funds (SEP, appropriated etc.) deployed directly to fund clean energy projects. Funds fill a gap, since most private lenders find lending to UnderServed market too risky.
- Impact: Done right, RLFs can fill important funding gaps. However:
  - SEOs need to be comfortable with operational requirements (origination, servicing).
  - SEOs need to be comfortable with potential headline and operational risks of loan charge-offs and collections.

Loss Reserves

- Example: California single family residential loan program (REEL program)
- Definition: A loss reserve is a small set-aside of funds, made at the time a loan closes/funds. The reserve is available to cover lender's losses if the lender charges off the loan. For example: 90% coverage of charged off loan, up to a maximum 10% of all a lender's enrolled loans.
- Impact: Best used to convince lenders to loan to borrowers with riskier credit profiles than they would otherwise be comfortable with. However:
  - SEOs need to be comfortable with taking on long-term responsibility for qualifying loss reserve enrollments and managing charge-offs/reserve claims over the life of loans.

Loss Reserve Example: California REEL Program

- California's state treasury operates a single family loan program with a two-tiered loss reserve:
  - 10% reserve set aside to convince lenders to offer better rates and terms for all borrowers. Available to all energy efficiency loans.
  - 20% reserve set aside to convince lenders to lend to low-moderate income households. Available only to energy efficiency loans made to low-moderate income households.
- Impact: 10% loss reserve has provided better terms for all borrowers – the benefit will vary depending on the type of lender. Lenders will find it most useful for lowest credit score borrowers. (Very few losses in high credit tiers).
  - 20% loss reserve still relatively untested, although lenders indicate interest.
- Note that a low credit score isn't always well-correlated with a low to moderate income borrower.

Debt Service Reserves

- Example: Commons Energy multi-family lending program
- Definition: A debt service reserve represents funds set aside to keep *payment* current. It does not require a charge-off to access. For example: 6 months debt service reserve would keep a borrower current for up to 6 months. Assumption is that a borrower will eventually make those missed payments up.
- Impact: Best to support EE investments for customers expected to have cash flow constraints (e.g. multi-family housing). However:
  - SEOs need to be comfortable with enrolling loans and managing the debt service reserve cash flows over the life of underlying loans – although this can be outsourced.

Loan Participations

- Example: Nebraska Dollars and Cents program supports EE throughout the state, in partnership with community banks.
- Definition: A SEO allows a bank or other investor to conduct all financial operations (origination and servicing). But SEO funds a part of the loan, perhaps taking on some of the first risk of loss.
- Impact: Provides one way to engage community banks in rural communities to lending for energy efficiency. However:
  - Establishing these relationships with banks can be time consuming, and will require long-term commitments from SEOs.

Partnerships

- Three categories of institution provide excellent partnership potential for an SEO
  - Housing finance agencies
    - Allocate federal tax credits that support construction of new multi-family housing [role: technical support to EE efforts operated by HFAs as part of the tax credit allocation]
    - May operate down payment assistance or mortgage programs for single family [role: technical support to EE integration in to these efforts]
  - Community Development Lenders [example: Funding Partners in Colorado – work with Energy Outreach Colorado].
    - Originate and service on behalf of state and local partners for energy efficiency
    - Conduct education and outreach AND financing programs for low-income
    - Maintain strong relationships with banks & foundations and deploy funds to low-moderate income communities on their behalf. Note especially banks and Community Reinvestment Act funds.
  - Banks
    - Partnership with banks looking to meet CRA needs in commercial markets.

Concluding Thoughts

- The UnderServed markets are often are often crowded with policy and programmatic options
- State housing authorities, state tax credit allocation authorities
  - Federal agencies (HUD, USDA and others) providing capital and insurance
  - Federal financing entities providing capital
  - Legislative bodies
  - Private development lenders (local economic development, neighborhood support lenders, low income lenders
  - Other private sector lenders
- Make sure that you are coordinating with and supporting these entities…don't try to go it alone

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