Policy Proposal: Investing in Competitive Clean Energy Act

OVERVIEW

Much of the dramatic growth of the clean energy industry over the past 30 years has relied on the provision of grants, incentives, rebates, policy initiatives, and technical support from state clean energy programs. However, continued growth will be limited as long as it relies primarily on deep public subsidy in the form of grants. 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, while at the same time providing public financial support in the form of credit enhancements, collateral support, guarantees, and other credit support 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. Additionally, efficient public incentives need to be better integrated with public finance programs that induce more private capital investment. A more integrated approach will allow clean energy companies and projects to achieve greater scale and tap into the capital markets.

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 clean energy investments. However, commercial banks are faced with much greater credit oversight than in the past and have, consequently, tightened their credit standards as they have regrouped in the aftermath of the Great Recession. 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. As a result, there is now a strong interest at the state level in finding ways to provide credit enhancement that attracts private investment to finance clean energy at a 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 level and not the federal level.

LEVERAGING PRIVATE INVESTMENT IN COMPETITIVE ENERGY SOLUTIONS

New approaches must be employed 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 innovative, state-directed model is essential for clean energy supply chain companies in need of financing for working capital, equipment, real estate acquisition, or improvements to their business premises. Flexible capital is also needed for project financings of on-site and district clean energy generation limited to eligible technologies, size limitations, and capital requirements. Addressing local challenges should be the prerogative of state leaders and not the focus of federal agencies. Through the Investing in Competitive Clean Energy (ICCE) Act, decision making remains with the states and is funneled to local investments in a collaborative manner.

INVESTING IN COMPETITIVE CLEAN ENERGY (ICCE) ACT

The Investing in Competitive Clean Energy (ICCE) Act would be an efficient means of attracting significant private investment to clean energy. The program would be housed in the U.S. Treasury. However, the underwriting and credit enhancement roles would be placed at the state and local levels. Treasury would develop broad guidelines outlining acceptable state financing structures, and Treasury would also 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 Investing in Competitive Clean Energy (ICCE) Act would target a 5:1 leverage ratio of private-to-public investment. In the instances where a state'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.

DEVELOPMENT FINANCE AGENCIES & STATE ENERGY OFFICES

Development finance agencies (DFAs) are public or quasi-public/private authorities that provide or otherwise support development through various direct and indirect financing programs. DFAs often issue tax-exempt and taxable bonds, provide credit enhancement programs, and offer direct lending, equity investments, or a broad range of access to capital financing mechanisms. DFAs are formed at the state, county, township, borough, or municipal level and often have the authority to provide development finance programs across multi-jurisdictional boundaries. Every state has authorizing language to allow for the creation of a DFA at both the state and local levels and nearly every state is active in this industry.

According to the National Association of State Energy Officials (NASEO), State Energy Offices (SEOs) support energy research, policy, and development to support the citizens' energy needs and energy security within their respective states. SEOs often see that advancing local energy solutions and advancing local economic development go hand in hand and will pursue partnerships to support both. Along with pursuing partnerships to support energy development, SEOs run energy efficiency programs and allocate more than $7 billion in funds nationwide. SEOs are funded through state and federal appropriations and usually work under their governors or legislatures.

DFAs have played an increasingly important role in clean energy development through direct energy project-related bond issuances and the establishment of energy efficiency revolving loan funds and Property Assessed Clean Energy (PACE) programs throughout the country. These efforts are being conducted at both the state and local levels routinely. DFAs are uniquely positioned to be the primary development finance credit provider under the Investing in Competitive Clean Energy (ICCE) Act.

Under the Investing in Competitive Clean Energy (ICCE) Act, each state would designate the state's primary development finance agency as the administrator of the program. The state Development Finance Agency (DFA) would work in collaboration with their State Energy Office (SEO) to establish policies, direction, and program structures and to apply for funds through the Treasury to deliver the program.

Additionally, state or local-level green banks, local DFAs, and CDFIs would be eligible sub-recipients of funds through the Investing in Competitive Clean Energy (ICCE) Act. Green banks, local DFAs, and CDFIs would have to adhere to all program rules and achieve the 5:1 leverage ratio.

ENERGY FINANCE PROGRAMS APPROACHES

In order to effectively address the credit challenges of the clean energy industry, the Investing in Competitive Clean Energy (ICCE) Act would include a cutting-edge mix of approved activities. Each of the designated types of credit support programs—loan loss and debt service reserves, letters of credit, loan guarantees, collateral support, funding warehouses, and subordinated debt—are important and familiar roles that Development Finance Agencies (DFA) play and would not result in heavy administrative or loan servicing burdens. Venture capital and capital access programs would not be eligible under the Investing in Competitive Clean Energy (ICCE) Act.

The Investing in Competitive Clean Energy (ICCE) Act 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 a 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.

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 (PABs)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. In addition, a state could develop a guarantee program to support bond issuances at the local level that capitalize PACE programs or local energy efficiency/renewable energy revolving loan funds.

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. Collateral support programs have emerged in the last decade to support small businesses and entrepreneurs who are entering new business markets but lack the collateral needed to reach bank lending standards.

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.

Warehouse Facility

Funding warehouses aggregate smaller projects to give them access to lower-cost private finance. A DFA or green bank establishing the warehouse would establish either master facilities to fund originators of smaller projects needing financing or a facility of its own to provide direct financing under standardized contracts for energy-related projects. Once aggregated, the DFA or green bank could issue bonds supported by the cash flows from the underlying projects as well as one (or more) of the credit enhancements noted above which would attract large financial institutions and institutional investors such as pension funds.

By appropriating $5 billion in funding for clean energy financing support, the Investing in Competitive Clean Energy (ICCE) Act will leverage an additional $25+ billion of private and other capital for clean energy-related companies and projects in every state in the nation, requiring very little federal administrative burden.

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ADDITIONAL RESOURCES

Energy Finance Resource Center
Council of Development Finance Agencies

State Clean Energy Finance Banks
Brookings Institute

Clean Energy Victory Bonds
Green America