

NASEO State Financing Committee Call Notes

Friday, August 3, 2012, 10:30-11:30am ET

Attendees:

Buildings Performance Institute
Cadmus Group
Energy Programs Consortium
Georgia Environmental Finance Authority
Kansas Corporation Commission
Kentucky Department for Energy Development and Independence
Michigan Energy Office
Minnesota Department of Commerce, Division of Energy Resources
NASEO
Nebraska Energy Office
Nevada State Office of Energy, Office of the Governor
NYSERDA
Oklahoma Department of Commerce
SAIC-Florida PACE Program
Washington Department of Commerce, State Energy Office
Vermont Public Service, Department of Planning and Energy Resources
Virgin Islands Energy Office

Welcome and Announcements:

Jeff Pitkin, NYSERDA Treasurer and NASEO Financing Committee chair, opened the call. He introduced Sandy Fazeli, NASEO's new Buildings and Energy Financing Program Manager, who has replaced Diana Lin in taking the lead on the Financing committee. She can be contacted by email at sfazeli@naseo.org or by phone at 703-299-8800 (office) or 571-447-6041 (mobile). Please contact Sandy if you would like access to Miriam Wrobel's presentation.

Jeff announced the day and time of the next Financing Committee call: Thursday, Sept. 6, from 3pm to 4pm ET. The call-in information for the Sept. 6th call is: 213-289-0155 (code: 6833636).

U.S. Treasury Guidance on QECBs

Jeff made note of guidance issued in July 2012 from the Internal Revenue Service on qualified energy conservation bonds (QECBs). This notice clarified what constitutes a qualified project for potential issuers of the remaining \$2.5 billion in QECB proceeds: specifically, how issuers should measure energy use reductions in publicly-owned buildings and what constitutes a green community program. Notice 2012-44 on Qualified Energy Conservation Bonds can be found here: <http://www.irs.gov/pub/irs-drop/n-12-44.pdf>.

USDA Rulemaking on Energy Efficiency and Conservation Loan Program

Sandy Fazeli and David Terry of NASEO noted that on July 26th, USDA released a notice about the new Energy Efficiency and Conservation Loan Program. The proposed rule would allow USDA through the Rural Utilities Service (RUS) to establish policies and procedures to implement energy efficiency loan programs aligned with USDA's Rural Economic Development Energy Efficiency (REDEEE) initiative. It would provide \$250 million for RUS borrowers to re-lend lower interest rate funds to homeowners and businesses to finance energy efficiency upgrades. RUS is expecting to issue the first loans in March 2013.

RUS is currently accepting comments on the regulation and is looking to have a range of particular questions answered. These cover issues of interest rates, the appropriate level of standards, and program funding. NASEO is willing to compile and submit comments on behalf of the Financing Committee; please get in touch with her at sfazeli@naseo.org if you are interested. More information about the proposed rule is available at http://www.rurdev.usda.gov/UEP_Homepage.html.

Presentation: “Trends in Energy Efficiency Financing”

Jeff introduced the presenter of the day’s call, Miriam Wrobel, Director in Citigroup’s Municipal Securities Division. Since Miriam joined Citi in 2010, Citi’s Municipal Renewables Group has financed over \$600 million of solar and wind projects, committed \$50 million to energy efficiency lending, and underwritten a \$70 million energy efficiency bond transaction. Within energy efficiency, Miriam focuses on both financing public sector efficiency projects as well as developing public/private partnerships to provide financing for private sector and residential efficiency programs. NYSERDA is currently working with Miriam and her team at Citi on QECBs.

Miriam opened her presentation by highlighting the sustainability initiatives that Citi is undertaking. These include \$50 billion committed in 2007 to combat climate change; participation in the White House/DOE Better Buildings Challenge (the only financing institution to participate); as well as industry and public recognition for their sustainability work.

Miriam is a banker within public finance. Her programs support public sector issuers and her clients are states, counties, municipalities, and higher education institutions. In addition to Citi’s work with NYSERDA, Citi has also worked with Delaware on state bond transactions and on a credit facility for Green Campus Partners. In the public facilities sector, her work promotes building retrofits, “smart” street and highway lighting, and other energy use reduction measures in intensive and industrial public operations.

Miriam provided a comparison of financing options municipal issuers may use for energy efficiency projects. These include bonds, tax-exempt leasing/installment purchasing agreements, and energy services agreements (ESAs). The main issue she identified in financing with tax-exempt bonds was aggregation. In order to engage in a tax-exempt offer, the issuer needs to have a critical mass of transactions; as such she encourages her clients to aggregate as many programs and projects as possible in developing a tax-exempt bonding program. She gave the example of Citi’s work with the Delaware Sustainable Energy Utility (SEU), whose revenue bond deal has resulted in net cash flow savings of more than 30% of the aggregate project cost.

Financing with a tax-exempt lease or installment purchase agreement is normally used for smaller projects. Often, financing comes through an energy service company (ESCO), which guarantees the minimum level of energy savings. The customer makes fixed payments based on the cost of the financed improvements.

Miriam stressed the usefulness of bundling projects in order to manage short-term and long-term financing. In this way, a short-term loan facility can allow for the issuer to aggregate projects or programs into longer-dated bond and lease transactions, providing greater opportunities to achieve critical mass, scale programs and manage administrative costs.

Using ESAs to finance projects involves a number of different players. A lender finances the construction of energy efficiency improvements. If an ESCO is involved, the ESCO guarantees a minimum level of savings to the project company, which puts in place a measurement and verification (M&V) protocol to administer the guarantee. Instead of debt payment or fixed lease payments, the customer makes payments

based on the percentage of delivered energy savings (as in a solar power purchase agreement, or PPA). Assets are owned by the project company during the term of services contract. The ESA structure allows project financing without balance sheet impact or debt creation.

The main ESA providers are Metrus Energy, Green Capital Partners, Transcend, and Abundant Power. The major insurance product for ESAs is provided by Energi. Because the ESA industry is a relatively new one, the major players change periodically.

Hamilton McLean of SAIC noted that in SAIC's work, they are running into issues ensuring the performance of projects. No one on the insurance product side has an incentive to protect the end-user (the customer). If the project does not result in savings, only the contractor and insurance company are covered. Miriam responded that with the ESA structure, the equity member has an incentive to have savings realized, and as a result serves as an advocate for the customer because their interests are aligned.

One spin on the ESA is the Managed ESA (MESA). In this structure, the project company takes control over the customer's meter, and the customer receives a guaranteed utility bill that is expense-neutral every month. The MESA is gaining traction in the commercial and industrial sectors, but has not yet seen much uptake in the public sector.

Miriam next focused her presentation on how the public sector can incentivize commercial and residential sector energy efficiency. There is an assortment of energy efficiency loan/debt products, which are usually distinguished by the way the customer is billed. A direct bill approach involves a municipality, servicer, or third party sponsor sending bills directly to clients. A Property Assessed Clean Energy structure bills customers through their property tax. On-bill repayment bills customers through their monthly utility bills. There are two phases of financing in commercial and residential sector energy efficiency: warehousing and takeout. Ultimately, the question that drives how limited public capital to support energy efficiency is: what is the easiest way to get loan products into the market so the state can minimize risk while also generating a return on investment?

In a Public/Private Energy Services Agreement (P3ESA), a state or municipality contributes subordinate debt or equity to enhance the credit of the private (commercial/industrial) customer, which helps provide a more attractive cost of capital to specific target businesses. A lender finances the project. The customer makes payments based on the percentage of delivered energy savings. If an ESCO is involved, the ESCO guarantees the energy savings, and this guarantee is administered by a project company. This structure, which allows state funds to go into enhancing a customer's credit, makes banks more comfortable with lending the money.

Q&A/Discussion

The discussion following Miriam's presentation opened with a question about what Citi's plans are for getting more involved in residential energy efficiency programs. Miriam noted that residential energy efficiency involves direct bill, on-bill repayment, and PACE program components. However, the Federal Housing Authority is undertaking new rulemaking, which (when it is completed) will help determine the direction of the housing market as a whole. While ESA doesn't really work for residential, Citi is still aggressive about opportunities to aggregate loans. Mark Wolfe of the Energy Programs Consortium added that the Warehouse for Energy Efficiency Loans (WHEEL) provides an opportunity to aggregate loans. Anyone who is interested in learning more can contact him directly: mwolfe@energyprograms.org.

Another question raised the issue of discounting, specifically: when Citi is bundling and securitizing residential portfolios of loans, are they discounted when they go into the market? Miriam responded that there is some discounting, depending on the credit profile of the loan pool and the reaction from rating

agencies. This is an issue that the WHEEL team is currently seeking to address with rating agencies, which traditionally have voiced concerns about discounting these loans.