Structuring Loan Loss Reserve Funds for Clean Energy Finance Programs

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Credit Enhancement Overview

- Risk sharing: can be instrumental to support Financial Institution (FI) energy efficiency (EE) & renewable energy (RE) lending
- Goals: pioneer new finance products, expand risk horizons, broaden access to finance, extend tenors, reduce rates
- Credit enhancements can support a range of finance models: FI loan facilities, bond issues, PACE, utility on-bill financing, etc.
- Credit enhancement structures include:
  - Loan Loss Reserve Funds
  - Subordinated Debt Structures
  - Guarantees

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Loan Loss Reserve Funds

Loan loss reserve funds ("LRF"):

- provide partial risk coverage to motivate commercial FIs to offer EE/RE finance products, pioneer new products, broaden access to finance, extend loan tenors, lower interest rates
- can be funded with public monies, e.g., ARRA (no guarantor is required)
- can support a range of EE/RE finance structures

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Loan Loss Reserve Funds

Loan loss reserve funds ("LRF"):

- cover <u>first losses</u> on a <u>portfolio</u> of EE/RE loans
- take a "portfolio approach" to credit structuring
- as a % of total loan portfolio principal = 2-10%
- achieve significant leverage of public funds

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Bellingham/Whatcom Co., WA:
Loan Loss Reserves, with 3rd Party Lender

- Sustainable Connections (SC) non-profit and local CAP provide "one-stop-shop", residential & small commercial:

  - Audits & Energy savings plans for a range of EE measures
  - Rebates, incentives & access to financing
  - Qualified contractors
  - Project performance measurement & evaluation
  - Consumer education & social marketing
  - Partnering with community institutions & utilities

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Bellingham/Whatcom Co., WA:
Loan Loss Reserves, with 3rd Party Lender

- Using City & County EECBGs and WA State SEP Credit Enhancement Grant for LRF & interest rate buy downs

- RFP process conducted to procure FI Partner

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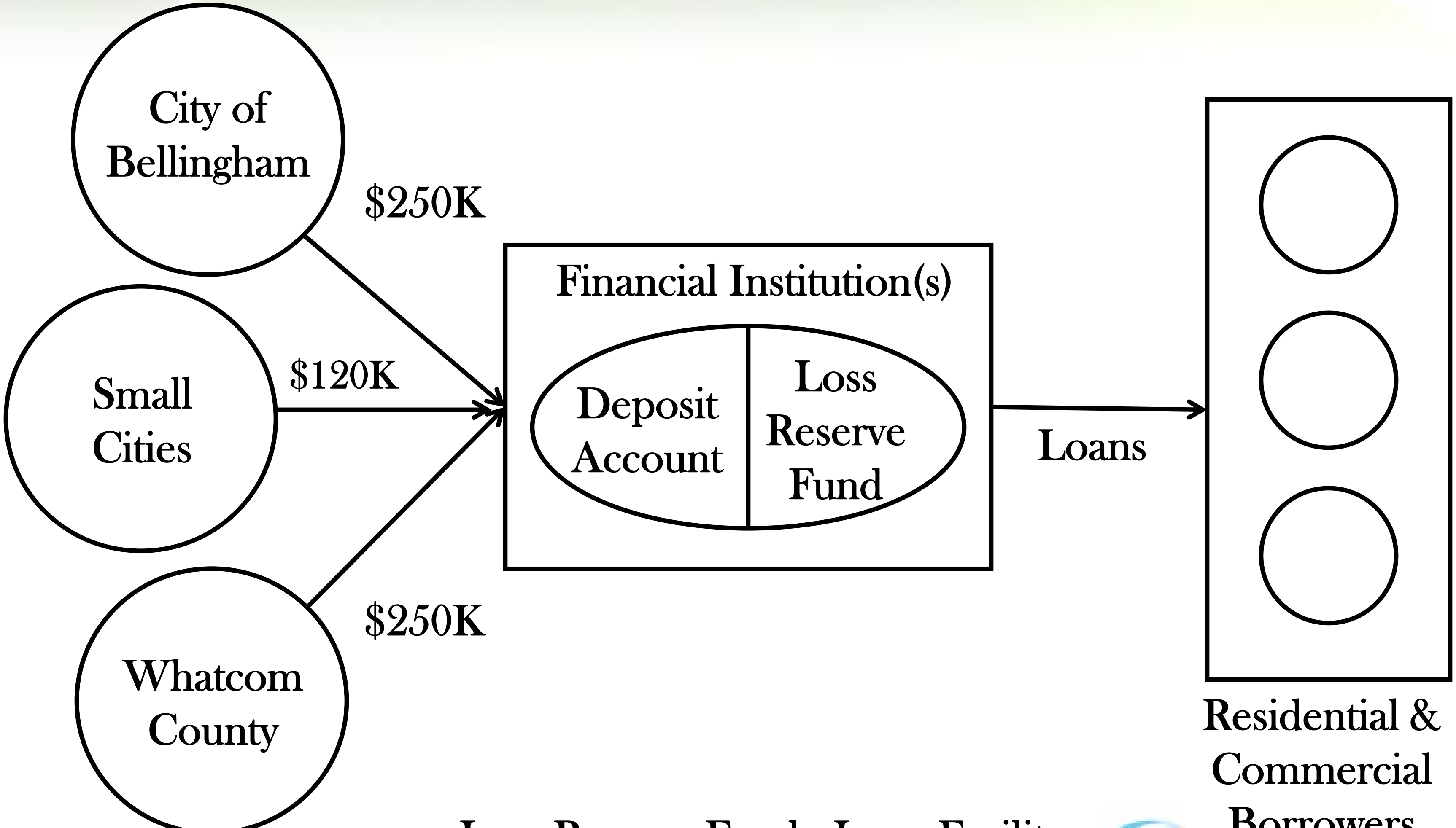
Loan Loss Reserve Structure



Loss Reserve Fund : Loan Facility
$620,000 : $6.2 million

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Potential Impacts on Underwriting Criteria

Use of LRF can have the following results:

- Reduces required credit score
- Increases debt to income ratio
- Lengthens loan tenor
- Allows larger unsecured loans
- Increases or eliminate loan to value ratio
- Lowers required customer capital contribution
- Lowers interest rate

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Program Implementing Agreements

- Loan Loss Reserve Agreement

  between the FI & Donor (City/County in Bellingham case)

- EE Loan Program Agreement

  between the FI & Program Administrator or Energy Services Providers

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Structure and Terms of EE Loans, to be defined in LRF Agreement

Key EE Loan terms address:

1) Eligible borrowers
2) Eligible projects & use of proceeds
3) Minimum/maximum loan size
4) Loan application & documentation
5) Loan tenors, maximum
6) Interest rate, index

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Structure and Terms of EE Loans, to be defined in LRF Agreement

7) Customer capital contribution
8) Payment schedule
9) Loan size
10) Loan underwriting guidelines and security
11) Loan disbursement and flow of funds during project construction
12) Prepayment option

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Risk-Sharing Formula: Main Components

- Ratio of (A) total original principal amount of Loans in portfolio, to (B) LRF funds. A/B = leverage ratio
- "First loss percentage" = portion of the total Loan portfolio original principal the LRF will cover, e.g., 2-10%
- Share of first losses that LRF will pay, e.g., 80-90%+; balance to the account of the FI. May have multiple LRF contributors.

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Risk-Sharing Formula: Main Components

- Trade-offs between the leverage ratio, risk sharing formula, Loan security and access to finance
- Incentives for good loan origination/administration are aligned

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LRF Agreement: Key Terms

- Definition of Deposit Account
- Definition of the Reserve Account
- Definition of Loss & Event of Loss
- Interest on both the Reserve & Deposit Accounts
- Responsibility for & Distribution of Recoveries
- EE Loan terms, Underwriting Criteria & Availability Period

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LRF Agreement: Key Terms

- Reporting & Monitoring
- Disposition of LRF funds at end of Program
- Program Fees, if applicable
- Lending targets & options to reprogram funds in the Deposit Account
- Portfolio Performance Targets & risk sharing formula reset values
- Accommodating the build up of the Portfolio

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EE Lending Program Agreement: Key Terms

- Agreement between FI partner & Program Manager, including roles of trade allies, vendors & contractors
- Defines all administrative coordination, responsibilities, roles & flow of information during project development and loan origination. Flexible agreement.

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EE Lending Program Agreement: Key Terms

- Marketing, approved literature
- Loan origination process
    - Credit screening
    - Loan application
    - Credit approval
    - Loan Agreement
- Training

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LRFs: Lessons Learned & Challenges

- Other examples: PA Keystone HELP; international experience; programs being set up in WA, CO, VA, etc.
- Best applied to portfolios of large #'s of loans
- Need source of concessional funds for the LRF
- Additional LRF contributors possible: vendors, FI, utilities, etc.
- Leverage ratios: can start low & increase with experience; include these terms in LRF Agreement

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LRFs: Lessons Learned & Challenges

- Make LRF assignable, supports secondary market
- Relatively easy to set up & administer
- Single vs. multiple FIs: a challenge
- Use of Escrow Agent separate from Lender to hold/manage LRF

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Thank You!

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