Public Finance Tools in the New Energy Economy

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I. WHAT ARE PUBLIC FINANCE TOOLS ANYWAY?

"Public Finance Tools" are the federal, state and local laws that make public funds available to local governmental entities and certain private entities to finance projects that are approved and deemed in the public interest by such federal, state and local governments.

1. Federal “Tools”
   - Tax-Exempt Bonds
   - Tax Credits
   - Federally Subsidized Taxable Bonds

A. Traditional Tax-Exempt Bonds

- Used to finance “good government” projects approved by federal government (example: financing water and sewer treatment plants)
- Used to finance certain exempt facilities (example: small manufacturing plants) that the federal and state government want to encourage
- Tax-Exempt Bonds allow the borrower to receive a lower interest rate because the interest paid on the bonds is generally excludable from federal and state taxation

B. Traditional “Tax-Credit” Bonds

- Designed to give the holder a tax credit as an incentive for the purchase of the Tax-Credit Bonds
- The Tax-Credit Bond market is generally less established and less efficient than the Tax-Exempt Bonds market
- Tax-Credit Bonds have seen supplemental coupons (charging interest in addition to the Tax-Credit) that makes it, in some cases, more expensive than borrowing on tax-exempt basis

C. 2009 Stimulus and Other New Energy Legislation

- As part of “The American Recovery and Reinvestment Tax Act of 2009” (the “2009 Stimulus”), Congress sought to incentivize a wide-range of governmental projects and financings

C. 2009 Stimulus and Other New Energy Legislation *(cont'd)*

– Build America Bonds ("BABs"):

- Expands the pool of Buyers of Municipal Bonds to the TAXABLE BOND MARKET (more than 10 times the size of the Municipal Bond Market)
- In a direct-pay BAB, the Federal government provides a subsidy to make up the difference between TAXABLE BOND RATES and the lower TAX-EXEMPT BOND RATES
- Subsidy may be lowered by Congress in the future (35% to 28%)

C. 2009 Stimulus and Other New Energy Legislation *(cont'd)*

- TAX-CREDIT BONDS AVAILABLE FOR CERTAIN energy and energy savings' related projects, including (i) Qualified Energy Conservation Bonds ("QECBs") (26 U.S.C. § 54D); and (ii) Clean Renewable Energy Bonds ("CREBs") (26 U.S.C. § 54C(a))
- To date, direct-pay taxable BABs are far more successful than TAX-CREDIT BONDS in the market

2. State Law “Tools” for “New Energy” Economy

A. Federal Law Typically Contemplates an "Issuer" for municipal bonds

– Example: City of Aurora issues $300M in tax-exempt bonds to finance a project for its water system

B. State Laws Implement Federal Tax and Stimulus Policy

- Some states have implemented, or are considering implementation of, specific laws to assist in the issuance of bonds to finance energy production and energy efficiency projects
- The “trendiest state policy development” in 2009 was Property Assessed Clean Energy (“PACE”) financing authorization

B. State Laws Implement Federal Tax and Stimulus Policy *(cont'd)*

- A rapidly changing area – 13 states implemented PACE legislation in 2009; at least 17 states now have PACE legislation
- Many websites are trying to track state law developments. *See* www.pacenow.org and www.dsireusa.org

C. PACE Programs

– Typical structure:
  - Local governments offer low-interest loans to property owners to pay for renewable energy improvements
  - Loans repaid by special assessments on the property
  - Funding provided by (i) issuing bonds, (ii) partnering with a financial institution, or (iii) tapping existing funds

C. PACE Programs *(cont'd)*

- Although at least 17 states, several cities and counties have enacted legislation enabling local governments to create PACE programs, implementation has been limited. Communities that have pioneered PACE projects include:
  - Berkeley, Palm Desert and Sonoma County, CA
  - Boulder County, CO
  - New Orleans, LA
  - Santa Fe, NM
  - Babylon, NY
  - Athens, OH
  - San Antonio and Austin, TX
  - Milwaukee, WI

- Colorado
  - Local governments, including special districts, authorized to create special improvement districts to finance wide range of renewable energy and energy efficiency improvements and projects, including:

- Solar water heating
- Solar thermal-electric
- Photovoltics
- Wind
- Biomass
- Hydroelectric
- Geothermal-electric
- Biodiesel and ethanol
- Fuel cells that do not use fossil fuels
- Insulation
- Windows and doors
- Automatic energy control systems
- HVAC systems
- Caulking and weather stripping
- Lighting
- Daylighting
- Energy-recovery systems

- New Mexico
  - Renewable Energy Financing District Act – authorizes cities, counties and towns to issue bonds repaid by special assessments
  - Solar Energy Improvement Special Assessment Act – authorizes counties to create rules for certifying certain private banks and financial institutions that are authorized to make loans to property owners for solar energy improvements. Loan comes from private lender, but is repaid via special assessments collected by county.

- New Mexico *(cont'd)*
  - As of December 2009 – Santa Fe working on establishing a PACE program

- Other States
  - Not all states have passed PACE legislation
  - Wyoming, for example, has state constitutional limitations that make these types of programs difficult
  - Many challenges at a state and local law level when you entangle governmental borrowing and private ownership of the assets financed

I. IMPLEMENTATION OF PUBLIC ENERGY PROJECTS

A. CREBs (New Clean Renewable Energy Bonds)

- States, political subdivisions and Indian Tribal governments may issue CREBs under the 2008 Energy Act that added § 54C to the Internal Revenue Code
- CREBs benefit from the 2009 Stimulus increase of the volume cap ($2.4 billion)
- CREBs can finance qualified renewable energy facilities which include:

Eligible CREB Renewable Energy Facilities

- Wind facilities
- Closed-loop biomass facilities
- Open-loop biomass facilities
- Geothermal or solar energy facilities
- Small irrigation power facilities
- Landfill gas facilities
- Trash combustion facilities
- Hydropower facilities
- Marine and hydroelectric renewable energy facilities

A. CREBs (New Clean Renewable Energy Bonds) *(cont'd)*

- Still very few have been done in the United States
- Tax-credit market difficult for these types of credits
- May need further legislative assistance

B. QECBs (Qualified Energy Conservation Bonds)

- States or local governments may issue QECBs as tax-credit bonds to finance government programs and initiatives designed to reduce greenhouse gas emissions
- Benefit from the increase in volume cap under the 2009 Stimulus to $3,200,000

B. QECBs (Qualified Energy Conservation Bonds) *(cont'd)*

- Volume cap allocated by states:
  - Colorado allocated by the Governor's Energy Office (example: Boulder County gets an allocation of \$3.0M and can petition the State for supplemental allocation)
  - May be able to designate PACE programs as a "Green Community Program" to increase scope of project allowed to be projects designated by local issuer and avoid limitation on private activity bonds
  - Example: Boulder County has sought state allocation for its Green Community Building Project as "Green County Program"

C. Problems with Tax-Credit Bonds

- Davis Bacon may apply
- Market not efficient
- High cost
- Would be cheaper to “BAB-TIZE” Tax-Credit Bonds
- Additional federal legislation anticipated

D. Adventures in Public Finance and Energy Savings Projects:

BOULDER COUNTY'S PACE PROGRAM
AND
ENERGY ASSESSMENT BONDS

- Boulder County Program Basics
  - **Purpose:** To provide full financing loans to owners of residential and commercial properties to encourage energy efficiency improvements and the installation of renewable energy technologies
  - **Goal:** To help residents and businesses save money and reduce their environmental impact
  - **Authority:** HB 08-1350 and County Ballot Measure 1A

- How the Boulder County Program Works
  - Limited energy efficiency and renewable energy measures
  - Property owners opt in
  - Special assessment placed on property – easy payment via property tax statement – repayment responsibility remains with the benefited property, even if homeowner sells the property
  - Up to the full upfront cost of improvements is loaned

- How the Boulder County Program Works *(cont'd)*
  - No cost to property owners who don't opt in
  - Link to rebate and incentive programs
  - Countywide pool of funds obtained through sale of bonds

- Project Difficulties
  - High cost to establish
  - High cost to administer for the County
  - TAXABLE MARKET (PRE-BABs)
  - Not favored by mortgage banking lobby (superiority of governmental lien deemed harmful to bank security)

E. A Vendor’s Perspective:

APPLYING THE NEW PUBLIC FINANCE TOOLS

- E.P. Act of 2005 § 179D
  (Transferable Depreciation Allowance)
  - Efficiency Energy, LLC is a private company that monetizes tax benefits derived from new/retrofit qualifying light, HVAC and envelope projects in government and commercially owned properties and coordinates proceeds with other financial incentives
  - Assets placed in service 01/01/2006-12/31/2013

- 100% project cost up to $0.60/sq.ft. per building system
- Percentage costs of project varies by type of energy savings project (example: lighting, HVAC and envelope) savings may be secured via surety/guarantee
- Example: Urban Transportation District might retrofit the lighting, HVAC and other portions of its facilities to achieve both economic savings and environmental goals that result in rebates/defrayments from past/future projects

- Difficulties under current federal and state laws:
  - Projects may be too small monetarily to justify traditional tax-exempt bond financing approach
  - Useful life of improvements may be too short to match with long-term debt
  - Savings deemed speculative by some issuers

- Developments for 2010 and beyond
  - What public finance tools would be ideal for issuers, manufacturers and vendors?
  - Would “BAB-tizing” the tax-credit QCEBs and CREBs help?

- Developments for 2010 and beyond
  - Will political will continue to exist for energy savings projects?
  - What can local governments do to take advantage? Example: Colorado's legislation permitting metropolitan (development) districts to create special improvement districts for energy efficiency projects