

Q&A with Michael Gergen and Josh Bledsoe

Green Banks: Financing Tomorrow's Clean Energy Projects

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In February 2014, lawyers from Latham & Watkins participated in the inaugural Green Bank Academy held in Washington, D.C. State energy and finance officials from across the US attended the Academy to discuss the role of green bank financing and opportunities for coordinated state action. The Coalition for Green Capital (a pro bono client), the Connecticut Clean Energy Finance and Investment Authority (CEFIA), and the Brookings Metropolitan Policy Program hosted the event.

In this lw.com interview, Latham partner Michael Gergen and counsel Josh Bledsoe discuss how state green banks can be used to accelerate the deployment of clean energy technology, products and services by leveraging existing public funds. Connecticut, New York and Hawaii are among the first states to create green banks, and California and some other states may be close on their heels.

What is a green bank?

Gergen: Green banks are entities that provide financing support for clean energy technology, products and services — including renewable energy generation projects and energy efficiency measures. They are intended to leverage public dollars to increase private capital investment that will accelerate and increase the number of clean energy projects that are deployed, with the goal of reducing greenhouse gas (GHG) emissions while promoting economic development in the clean energy and cleantech sectors.

How are green banks funded at the state level?

Gergen: There is no one way to fund a green bank. For example, state green banks can be funded by taking existing public programs and repurposing the dollars by using them to capitalize a green bank. A number of states already have publicly funded grant programs for renewable generation and energy efficiency projects. Instead, you could take that grant funding for which the public sees no direct return of and on its investment and put it into something that looks like a revolving loan fund.

So instead of giving a grant, the green bank would provide lower-cost financing support in the form of a loan or some other form of financing support, such as a credit enhancement, project aggregation and securitization. And in this way, the green bank would get money back — it could replenish its capital. In fact, if the green bank is prudent in its financing support activities, it should make more back than it gave out — even though it's a non-profit — and could use that return of and on its past financing support to provide financing support to other clean energy projects.

Bledsoe: It really stretches any public dollars that are used to set up or capitalize a green bank. You can recycle that dollar to leverage private capital.

How can green banks change the economics of clean energy projects?

Gergen: It will depend on how green banks provide financing support for clean energy projects. If you look at the capital costs for a distributed generation solar projects or an energy efficiency project, a green bank could lower their cost of capital if it can provide them access to lower-cost forms of private capital, such as that available in the public capital markets.

Or if you think about people who are out developing distributed generation renewable projects or energy efficiency projects, a developer might have 100 projects they want to develop. But it's all going to be a question of economics to finance the projects. One group of projects might make economic sense if a developer can obtain equity and debt financing at a combined cost of 10 percent and another group of projects might only make economic sense if the developer can obtain such financing at a combined cost of 8 percent. If you think about these pipelines of projects, and

you lower their cost of capital — there may be more projects that can get developed and deployed with green banks.

What types of projects can be funded using a state-level green bank?

Gergen: At the state level, what initially have been the ideal project for green banks are distributed generation solar projects, though efforts on the energy efficiency front to promote the aggregation and securitization of these projects are quickly ramping up.

To give an example. On the distributed generation solar front, Connecticut's green bank, CEFIA; Mosaic, a solar finance crowdsourcing company; and Sungage Financial, a solar financing platform company, have set up a crowd-funded financing mechanism for residential distributed generation solar projects.

Many homeowners today can arrange to have a solar electric system installed on their rooftop; there are lots of vendors out there selling the service — where the homeowner enters into a long-term off-take arrangement with the vendor in the form of a lease or power purchase agreement and in exchange does not have to pay the up-front cost out of pocket to put the system on their roof, or obtain financing from a third-party lender to do so.

CEFIA is funding loan originations and providing credit enhancements that have enabled Mosaic to lend crowd-sourced funds to homeowners in Connecticut to cover the up-front cost of rooftop solar projects. So a homeowner still gets the advantage of not having to pay out of pocket to put the system on their roof. But the crowd-sourced private capital being provided through Mosaic in the form of direct loans is at a very attractive rate as compared to what is currently available under long-term leasing or power purchase agreements. At the same time, Mosaic can start building up an inventory of these loans and warehouse them, package and resell them, and then use the money to replenish the fund they have to make more loans.

To give another example, on the energy efficiency front, CEFIA very recently did a deal to securitize a portfolio of loans for energy efficiency projects in the commercial sector; what some in the clean energy industry are referring to a first-of-a-kind deal. CEFIA is keeping a portion of these loans on a first loss basis to provide credit enhancement to the portion it sold. CEFIA will use the proceeds from this deal to fund new loans and replenish its loan warehouse facility for these types of loans.

How have states like Hawaii and New York created green banks?

Gergen: A green bank was established in Hawaii through legislation with the support of the governor and a number of other senior-level people in the legislature. Energy in Hawaii, particularly at the retail level for electricity, is very expensive because the state relies very heavily on diesel oil-fired generation. Hawaii also has very strong solar and wind resources and is already a very attractive market for distributed generation solar for homeowners with high credit scores, so it became a very attractive place to set up a green bank to try and expand the market to a broader range of potential customers.

New York Governor Andrew Cuomo in his 2013 State of the State address announced that the New York State Energy Research and Development Authority (NYSERDA) would be the vehicle for creating a New York Green Bank that would attract private capital investment in energy efficiency and clean energy projects. He also proposed US\$1 billion in capitalization for the bank. The New York Green Bank is now up and running and has an initial capitalization of US\$218.5 million sourced from repurposed public funds.

What are some of the key factors involved in the successful creation of state green banks?

Gergen: You need strong support from state policy makers and stakeholders. I don't know that this support has to be at the level of the governor, but what we've seen so far in New York, Connecticut and Hawaii suggests that such support can be critical.

It's also critical to see if there really are existing public funds and programs targeted at clean energy that could be better used by being repurposed for a green bank. You could have a situation where there are not existing sources of public funds for clean energy investment and the state would have to impose new costs on rate payers or new taxes on tax payers to fund a green bank — and that could be a hard sell. And if you have a state with really good programs already in place that are doing an effective job of getting projects deployed — there may not be a need for a green bank or as pressing of a need for a green bank as we've seen in other states.

Latham is experienced at working with policymakers and stakeholders in individual states to help them determine

possible structural and funding options for a green bank. For example, we have helped them determine where the existing public funding sources are, how they are being used and whether they can be legally repurposed. We have also helped them determine whether there are limitations on how a state green bank can be structured and placed. In Connecticut, for example, CEFIA is a free-standing entity — it's a quasi-public corporation. In contrast, in New York, the New York Green Bank fits within an existing government agency.

To run a green bank successfully, you need a different kind of mindset. Green banks are trying to be market enabling. It's really about using public funds as a lever to increase private capital investment in clean energy. You need people to come in and run a green bank more like an investment bank than a government grant program. This is definitely the path that the New York Green Bank and CEFIA have pursued with some success.

Why is California an attractive market to establish a green bank?

Gergen: California already has a greenhouse gas cap and trade scheme, and it sells allowances that have value. So there is a potential revenue source that didn't exist before, and ideally some of that money would be used as capital for California's state green bank.

Bledsoe: Indeed, California's Cap-and-Trade Program already is raising substantial revenue for the state via the quarterly auctions where "allowances" (essentially a permit to emit one metric ton of carbon dioxide) are sold. The state will raise even more revenue starting in 2015 when fuel suppliers are phased into the Program; some recent projections suggest annual revenues of about US\$5 billion. Importantly, state law provides that this revenue must be used to further reduce GHG emissions. We think a green bank may be the best way to spend some of this revenue due to a green bank's ability to recycle public dollars. In other words, a green bank may provide the best bang-for-the-buck for achieving reductions in GHG emissions.

Further, even if no Cap-and-Trade Program auction revenue is used to capitalize a California green bank, the state's climate policies demand steep reductions in GHG emissions. Accordingly, California is, and will be, on the lookout for new and innovative ways to reduce GHG emissions. Again, we think a green bank could be a means to achieve those reductions at a lower cost to the public. As such, a green bank ultimately may be attractive to California regulators and legislators.

Finally, California is home to a robust and growing cleantech industry. Many California cleantech companies have a demonstrated need for new forms of financing, which a green bank could help provide. In short, we think a California green bank could meet an existing need.

What are some of the challenges facing the establishment of a green bank in California?

Bledsoe: Counterintuitively, the largest challenge may derive from the fact that California has been a leader on addressing climate change and other environmental issues. As such, there are numerous existing governmental programs that are designed to deal with similar issues, but are not always rowing in the same direction or at least at the same cadence. A California green bank could serve a coordinating function and help to maximize the efficiency and impact of these existing programs. But that is a complicated and time consuming task, which could slow the establishment of a California green bank.

Also, there probably are more agencies in California than in any other state that are actively working on clean energy issues (e.g., the Air Resource Board, the California Energy Commission, the California Public Utilities Commission). Accordingly, part of this is an outreach and education effort, which just takes time when there are so many interested policymakers and stakeholders. Finally, there are many organizations with designs on the Cap-and-Trade Program auction revenue, so it is possible that this funding source may not materialize and a California green bank would need to find other sources of funds for its capitalization.

CONTACTS

Michael J. Gergen
Washington, D.C.
T +1.202.637.2188
michael.gergen@lw.com

Joshua T. Bledsoe

Orange County
T +1.714.755.8049
joshua.bledsoe@lw.com

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