SMALL-SCALE LOCAL ENERGY LOAN PROGRAM

2019 Report to the

OREGON LEGISLATURE

by the

OREGON DEPARTMENT OF ENERGY

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OREGON DEPARTMENT OF ENERGY

Executive Summary

In 1979, the Small-Scale Local Energy Loan Program (SELP) was established by the Oregon State Legislature under ORS Chapter 470 to provide long-term fixed rate loans for Oregon energy projects. Over the program's history, the Oregon Department of Energy (ODOE) has issued more than 900 loans, with an associated $612 million in financing, to recipients located across all 36 Oregon counties.

SELP has helped support State of Oregon energy policy by providing public, private, and tribal stakeholders access to energy project capital for qualified Oregon energy projects that invest in energy conservation, renewable energy, and alternative fuels, or that create products from recycled materials. SELP operates under authority established by ORS Chapter 470. SELP relies on program fees and loan interest to sustain operations. Historically, capital for loans was raised through the issuance of Article XI-J general obligation bonds.

SELP program activity is supported by the Small-Scale Local Energy Project Advisory Committee (SELPAC), a nine-member director-appointed committee representing the interests of Oregon citizens. SELPAC provides broad subject matter expertise in the areas of energy technology, natural resource development, environmental protection, finance, agriculture, local and regional governance, and utility operations. SELPAC assists SELP by making recommendations on loan applications and standards for small-scale local energy projects.

ODOE did not have bonding authority for the 2017-19 biennium covered by this report. Consequently, there are no new SELP loan originations to report. While the lending aspect of the program has been on hiatus since 2015, ODOE has continued to work diligently to improve the program's financial condition. For example, ODOE has reduced the budget deficit by more than $7 million through a combination of bond refinancing, restructuring of debt, and collection activity.

The following SELP balance sheet and income statement summary is drawn from the program's audited financial statements and reflects a reduction in the program's net position. The reduction in net position represents a deterioration in the financial condition of the program, even though the program had positive net income (change in net position) in fiscal year 2018, due to the depletion of program cash reserves to pay program bond debt. SELP cash flow is negative because the amount of assets that generate cash (loans) is significantly smaller than the amount of program liabilities that use cash (bond debt). This mismatch in the program's balance sheet is the result of the default of high-risk loans that occurred between 2007 and 2012 and the lack of new loan origination since 2015.

	Period Ending June 30, 2017	Period Ending June 30, 2018
Program Assets	$ 175,397,683	$ 155,085,042
Program Liabilities	$ 189,563,681	$ 170,900,018
Net Position	$ (10,353,149)	$ (12,509,301)
Program Revenue	$ 8,623,028	$ 7,800,468
Program Expense	$ 9,900,384	$ 7,119,505
Change in Net Position	$ (1,067,783)	$ 927,566

The depletion of program cash reserves is not sustainable and has impaired the financial solvency of SELP. The program will require, for the first time in its history, General Fund support to meet debt service payments in 2021. $4,334,048 in funding to meet these 2019-21 biennium obligations was provided by the 2019 Legislative Assembly in SB 5545.

The Oregon Department of Energy is currently focused on prudently managing the existing SELP loan portfolio to limit the effect of the program's deficit on the General Fund and developing recommendations, with stakeholder input, to improve the program to ensure SELP is appropriately positioned to meet Oregon's current energy goals.

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I. Introduction

For more than 35 years, the Small-Scale Local Energy Loan Program has helped individuals, businesses, tribes, nonprofits, and public sector agencies pursue energy efficiency and renewable energy goals. Through SELP, ODOE has issued more than 900 loans, with an associated $612 million in financing, to recipients located across all 36 Oregon counties.

As this report outlines, SELP is not currently writing or developing new loans. SELP staff are focused on working closely with existing borrowers to help ensure current loan repayments are managed carefully. Further, SELP staff are working with the program's volunteer advisory committee and other external stakeholders to examine and explore the role of the SELP program and how it can provide value to Oregonians and advance the state's energy goals. With the advisory committee's guidance and other stakeholder input, ODOE hopes to develop thoughtful and realistic recommendations for legislative consideration on the program's future that incorporate an understanding of current credit and energy sector markets in Oregon, emerging energy technology, state energy goals, and the state's tolerance for financial risk.

Program Background

The Small-Scale Local Energy Loan Program (SELP) was established by the Oregon State Legislature in 1979 under ORS Chapter 470. A legislatively-referred constitutional amendment to authorize the issuance of state Article XI-J bonds for small-scale local energy projects passed in 1980. SELP supports State of Oregon energy policy by providing public, private, and tribal stakeholders access to energy project capital. SELP issued Article XI-J general obligation bonds to originate fixed-rate long-term loans for qualified Oregon energy projects that invested in energy conservation, renewable energy, and alternative fuels, or that created products from recycled materials.

Over SELP's 35-plus-year history, the program has issued more than 900 loans, with an associated $612 million in financing, to recipients located across all 36 Oregon counties. Historically, a lack of access to project capital had been a barrier to energy project development. SELP played an important role in insuring project capital was available to support the implementation of energy projects that advanced Oregon's energy related goals.

Program Operations

The loan program operates as an enterprise fund and relies on program fees and loan interest to sustain operations. SELP made its first loan in 1981 and the program was intended to operate without general fund support. The program manages two major funds to carry out program activities:

Small-Scale Local Energy Project Loan Fund

This fund and its sub-accounts, created by Article XI-J of the Constitution and appropriated to the Department under ORS 470.130 to hold the proceeds from article XI-J bond sales, is the funding source for program loans.

Small-Scale Local Energy Project Administration and Bond Sinking Fund

This fund, created under ORS 470.300, is the source for payment of all loan program expense. The sinking fund and its sub-accounts consist of all program fees and interest earned, program loan receivables, monies transferred from the Small-Scale Local Energy Project Loan Fund, and any gifts, grants, or legislative appropriations.

SELP has the legal authority to issue taxable and tax-exempt state XI-J general obligations bonds including private activity bonds to fund approved loan requests. The sale of XI-J bonds is facilitated by the State Treasurer through the Debt Management Division and only occurs after a loan has been approved. Because costs associated with issuing debts can be significant, the Debt Management Division typically requires the department to identify approximately $5 million in approved loans before authorizing a bond sale. Loan amounts less than $5 million can be funded via a bond sale; however, doing so may require combining SELP loans with other state programs in the same sale. This can increase the complexity and cost of a sale and is therefore used infrequently.

The loan program historically used internal cash flow generation to fund smaller loans that are not large enough to merit the sale of bonds. This process involves transferring resources from the Small-Scale Local Energy Project Administration and Bond Sinking Fund to the Small-Scale Local Energy Project Loan Fund. The transfer of funds from the bond sinking fund to the project loan fund may only occur during periods of sinking fund adequacy as articulated under ORS 470.300(3).

The Small-Scale Local Energy Project Advisory Committee (SELPAC), a nine-member appointed committee representing the interests of Oregon citizens, supports SELP program activities by providing broad subject matter expertise in the areas of energy technology, natural resource development, environmental protection, finance, agriculture, local and regional governance, and utility operations.

Program Challenges

SELP has a forecasted deficit in the Small-Scale Local Energy Project Administration and Bond Sinking Fund. As of June 30, 2019, the cumulative deficit is projected at $8.7 million through 2034, with the first bond sinking fund shortfall projected to occur April 2021. A projected deficit in the bond sinking fund was first recognized in December 2008 and has been reported since

that time on SELP financial statements, official bond sale summaries, and in the program's biennial reports to the Legislature.

The sinking fund deficit is the result of $34.9 million in loan losses sustained on loans the department originated between the years 2007 and 2012. Of the $34.9 million in losses suffered, over $28 million is attributable to losses from two loans: Cascade Grain Products, LLC ($18.1M) and Peak Sun Materials Corporation ($10.2M). These two losses represent 74 percent of program loan losses to date. Due to these loan losses, SELP has fewer cash generating earnings assets to meet the ongoing cash requirements of operating the program. The single largest program expense is debt service on the bonds issued to fund loans.

ODOE was not granted bonding authority for SELP for the 2017-19 biennium. Consequently, the loan program is currently unable to originate new loans and thus unable to meaningfully contribute to reducing the bond sinking fund deficit through new loan revenue. Given the scope and timing of the current sinking fund deficit, SELP will require General Fund support in 2021 in order to pay its bonds even if the program immediately resumes new energy loan originations.

Though the agency cannot issue new loans, ODOE has been aggressive in reducing the deficit through expense reductions. Through fiscal year-end 2018, SELP expenses for direct program administration was reduced by five percent compared to the prior biennium, with additional reductions in program operating expense due to the retirement of bond debt over the same time period.

Like any loan program, SELP is subject to market forces that affect the cost of capital. As SELP's cost of capital rose relative to other lending programs such as private capital markets, the demand for SELP loans decreased for many projects. In 1980, the U.S. prime lending rate was 21.50 percent. In 1981 the prime rate ended the year at 15.75 percent, and SELP originated loans at an average rate of 10.9 percent. From 2008 to 2015, prime rate was unchanged at 3.25 percent; currently prime is 4.25 percent, and SELP originated loans in 2015 at an average rate of 4.38 percent with half of the loan originations receiving an interest rate subsidy under the High-Performance Schools Pilot program. Historically, bond-funded SELP loans were generally cheaper than loans offered by private capital markets; however, this price differential reversed over time. While the current interest rate environment may become more favorable for SELP, SELP loans no longer represent "low-cost" funds, particularly for low-risk projects. Consequently, even if bonding authority were authorized, it would be unlikely that SELP would be able to grow its loan portfolio absent increases to the program's risk tolerance or material changes in commercial credit markets or the energy sector.

II. SELP Financial Overview

The following SELP balance sheet and income statement summary is drawn from the program's audited fiscal year-end financial statements and reflects an increase in net position compared to the prior year due to positive net income in fiscal year 2018, primarily due to a reduction in program expense. Program expense in 2017 was extraordinarily high due to a one-time expense of almost $3 million for the program's loan loss reserve necessary to account for a reduction in the expected recovery value of one large loan.

	Period Ending June 30, 2017	**Period Ending June 30, 2018**
Program Assets	$ 175,397,683	$ 155,085,042
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Despite positive net income in fiscal year 2018, the Net Position of SELP decreased compared to the prior year. This reduction in net position represents a deterioration in the financial condition of the program due to the depletion of program cash reserves to pay program bond debt consistent with the sinking fund deficit described under the Program Challenges portion of this report. The current cash balances held by the SELP program are not sufficient to meet all program expenses for the current biennium. SB 5545, passed in the 2019 legislative session, appropriated $4,334,048 to ODOE to pay SELP bond debt service through the 2019-21 biennium. Due to program expenses trending lower and loan pre-payments, the agency's most recent projections for the program indicate that the program will need an estimated $3.7 million in General Fund support to meet required bond payments on April 1, 2021.

The SELP forecasted cash flow deficit will persist through the life of the existing bond debt, which runs through 2034, with a cumulative cashflow shortfall currently estimated at $8.7 million. The program forecasts loan portfolio revenue through 2035 so a small cash flow surplus is projected over the final year of the program. The scope of the cash flow deficit is dynamic and is a function of anticipated loan repayment and program expense; consequently, the deficit forecast will change over time. If funds in the SELP bond sinking fund are sufficient, ORS

470.300 requires ODOE to reimburse the General Fund for any appropriations made to the department for SELP bond payments.

The following summaries of SELP cash balances at fiscal year-end 2017 and 2019 recap and illustrate the deterioration of SELP's cash position over time.

SELP Cash Balances as of June 30, 2017	
Small-Scale Local Energy Loan Fund	$ -
Small-Scale Local Energy Admin & Bond Sinking Fund	
Principal & Interest Received	$ 7,817,919.66
Extraordinary Expense	$ 986,397.00
Borrower Revenue Loss Reserve	$ 1,722,713.54
Bond Debt Service	$ 6,659,364.78
Program Administration	$ 287,917.72
Total	$ 17,474,312.70

SELP Cash Balances as of June 30, 2019	
Small-Scale Local Energy Loan Fund	$ -
Small-Scale Local Energy Admin & Bond Sinking Fund	
Principal & Interest Received	$ 5,107,178
Extraordinary Expense	$ 986,397
Borrower Revenue Loss Reserve	$ 2,138,276
Bond Debt Service	$ 4,981,105
Program Administration	$ 205,437
Total	$ 13,418,395

III. Energy Loan Activity - January 1, 2018 to Present

ODOE was not granted bonding authority for the period covered by this report. Therefore, no new SELP loans were made.

IV. Current SELP Program Activity

SELP staff continue to work closely with existing borrowers to help ensure current loan repayments are managed appropriately. In addition, ODOE continues to evaluate whether the SELP program, as currently constructed, provides value to Oregonians and advances the state's energy agenda. With SELPAC's guidance and other stakeholder input, ODOE hopes to develop thoughtful and realistic recommendations for legislative consideration on the program's future that incorporate an understanding of current credit and energy sector markets in Oregon, emerging energy technology, state energy goals, and the state's tolerance for financial risk.

FOR MORE INFORMATION

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