OREGON DEPARTMENT OF ENERGY

Energy Lending Programs

History, Goals, and Program Administration

The Small Scale Energy Loan Program (SELP) was established by the Oregon State Legislature in 1979 and codified in 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 issues Article XI-J general obligation bonds to originate fixed-rate, long-term loans for qualified Oregon energy projects that invest in energy conservation, renewable energy, and alternative fuels, or that create products from recycled materials. Over SELP's nearly 40-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.

Program Operations

SELP operates as an enterprise fund, which means the program acquires its own funds through bond sales, and relies on program fees and loan interest to sustain operations. SELP made its first loan in 1981, and has operated continuously without general fund support. The program operates two major funds to carry out program activities:

Small Scale Local Energy Project Loan Fund

This project loan fund and its sub-accounts is the funding source for SELP loans. It was created by Article XI-J of the Constitution and appropriated to the Oregon Department of Energy under ORS 470.130 to hold the proceeds from article XI-J bond sales.

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 expenses. 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 capacity 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 ODOE 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 needs 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 has 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 when the sinking fund balance is sufficient to cover all forecasted program expense as articulated under ORS 470.300(3).

Current Program Status

Fund Status

SELP has a forecasted deficit in the Small Scale Local Energy Project Administration and Bond Sinking Fund. The cumulative forecasted deficit is currently $8.6 million through 2034, with the first bond sinking fund shortfall projected to occur in 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 $30.7 million in loan losses sustained on commercial loans ODOE originated between 2007 and 2010. Of the $30.7 million in losses, 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 loans represent 84 percent of program loan losses to date.

In December 2015, SELP staff was notified by the Debt Management Division that the Treasury Department would not facilitate additional SELP lending, eliminating any potential bond funding for energy projects or access to additional capital resources. Therefore, SELP is currently unable to originate new loans and cannot meaningfully contribute to reducing the bond sinking fund deficit through new loan fees.

Deficit Reduction

ODOE has been aggressive about reducing the deficit. Between October 2016 and February 2017, the department worked hand-in-hand with public borrowers to refinance a portion of the bond debt. While the bonds will still have the same maturity date, the refinancing reduced SELP's interest expense by about $3 million and realized an equivalent amount of savings for the borrowers. ODOE has also carefully controlled expenses, keeping numerous staff positions unfilled as existing staff manage the SELP portfolio and work closely with borrowers to support repayment.

Lending Rates

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, ending the year at 15.75 percent, while SELP originated loans at an average rate of 10.9 percent. From 2008 to 2015, the U.S. prime rate was unchanged at 3.25 percent. 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 is becoming more favorable for SELP, SELP loans no longer represent "low-cost" funds for commercial projects. Consequently, SELP will likely experience limited commercial loan portfolio growth unless the program's tolerance for risk increases or there are material changes in commercial credit markets or in the energy sector.

Future of SELP

To effectively evaluate the future of SELP, ODOE first brought on two temporary employees with extensive experience in state accounting and bonding to examine and stabilize program bookkeeping. At the same time, the department hired an outside party to develop a cash modeling tool that allows for accurate forecasting of the program's cash flow in order to better manage the program's forecasted deficit. By 2016, the department had fully staffed the accounting functions of SELP, and by 2017 had reduced the cash flow deficit by several million dollars through diligent control over program expenses and the aforementioned refinancing effort, which yielded savings for both SELP and its public sector borrowers.

The department similarly conducted an extensive review of the lending portion of SELP operations. In addition to an in-house review of SELP underwriting, in 2016, ODOE hired a well-regarded commercial lender to conduct an independent evaluation of SELP credit policies and practices and to make recommendations for potential improvement. This lender reviewed program operations and loans, and conducted interviews with staff and with Small Scale Local Energy Loan Program Advisory Committee members before producing a series of recommendations. In the same vein, in 2016, ODOE hosted lending personnel from the Oregon Business Development Department as they conducted a review of the SELP loan portfolio at the direction of the Governor.

The results of these two reviews indicated the department needed to update SELP administrative rules to make provisions for additional underwriting rigor, and to place limits both on the size of loans originated by the program and on the loan advance rates of certain types of collateral. These recommendations were based heavily on the observed risks of the program's commercial sector loans, which comprise 36 percent of the total loan portfolio with the balance being loans to public entities. The department elected to delay rulemaking on SELP in order to allow for the legislature to set program direction stemming from a full agency review in June 2016 by the Joint Interim Committee on Department of Energy Oversight. The work of the Joint Committee, completed in November 2016, produced no consensus recommendations on SELP. However, legislation introduced during the 2017 legislative session was informed by the Joint Oversight Committee – HB 3166 – and would have transferred the duties, functions, and powers related to SELP from ODOE to the Oregon Business Development Department (OBDD). In addition to the transfer of the program, HB 3166 specifically called for more prescriptive standards and criteria adopted under program rules, a heightened focus on good and sufficient collateral, and refinements to strengthen the program advisory committee.

The 2017 legislative session ended without HB 3166 passing, leaving SELP under ODOE's authority. In anticipation of a likely transfer of the energy lending program to OBDD, bonding authority was not allocated to ODOE for the 2017-19 biennium related to the issuance of SELP loans. Consequently, ODOE does not anticipate making any SELP loans during the biennium. If directed, SELP does have the capacity to begin originating new loans if funding authority is addressed. However, the program currently operates with the smallest FTE sufficient to ensure continued loan portfolio management and compliance with required bond and accounting related functions, and most business development and agency-related outreach involved in cultivating new loans has been curtailed. In the absence of new loan development, SELP staff are currently focused on working closely with existing borrowers to help ensure current loan repayments are managed appropriately.

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Energy Lending Programs

Statement of Purpose

This concept removes and clarifies statutory language related to outdated and dormant energy programs under ORS Chapter 470, and it improves the efficiency and risk profile of the Small Scale Local Energy Loan Program (SELP) by updating its mission to focus on supporting public projects that provide public benefit and expanding the types of eligible projects.

Summary of proposed changes:

- Refocuses SELP on public sector energy projects because the program's bond funding mechanism aligns poorly with most private sector projects, resulting in increased program cost and risk. It is anticipated that under the updated mission, SELP will continue to advance state energy objectives through increasing energy efficiency in public buildings, reducing emissions in public fleets, and facilitating increased adoption of energy storage and related energy resiliency technology.
- Expands the definition of eligible projects to include emission reduction projects, resiliency projects, and energy storage projects.
- Removes recycling projects as an eligible project type.
- Removes the requirement to develop a commercial markets-focused marking plan.
- Expands the scope of biennial legislative reporting to include ongoing program evaluation.
- Reorients the composition of the Small Scale Local Energy Project Advisory Committee (SELPAC) to appropriately provide support for SELP's updated mission, and to review applications under the Clean Energy Deployment Program.
- Adds transportation expertise to SELPAC.
- Adds two ex officio, nonvoting members to SELPAC.
- Removes the ability for an applicant to appeal a loan decision to the Governor's office through SELPAC.
- Adds language clarifying ODOE's rulemaking authority under the Clean Energy Development Program.
- Repeals outdated provisions under ORS Chapter 470, including the Energy Efficiency and Sustainable Technology Loan Program, a program that has no funding and made no loans, as well as the High Performance Schools Pilot Program that was completed in 2015.

Statement of Need

SELP was established by the Oregon State Legislature in 1979; a legislatively-referred constitutional amendment to authorize the issuance of state Article XI-J bonds for small scale local energy projects passed in 1980. The Oregon Department of Energy, through SELP, currently supports State of Oregon energy policy by providing public, private, and tribal stakeholders with 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. 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.

However, SELP's bond funding mechanism aligns poorly with most private sector projects, resulting in increased program costs and risks as follows:

- The average SELP loan size is very large, which leads to systemic loan loss risk as each loan carries significant corresponding bond debt.
- SELP has been historically forced to fund small loans via cash from the program's sinking fund, which reduced the program's capacity to absorb future loan losses.
- SELP has historically been staffed at a high FTE, which is necessary to cultivate commercial business in all parts of the state, and reduces program net revenue.
- Some of the requirements related to bond funding introduce applicant risk, which encourages the safest and best qualified projects to seek funding elsewhere, and raises overall program risk.
- Most commercial SELP lending activity is in direct competition with private sector lending institutions, and feedback from private lenders suggests a desire to see SELP function more cooperatively with Oregon lending institutions.

SELP has a $152 million active loan portfolio, with 79 percent of loans to public bodies. SELP is currently operating under an $8.6 million cash flow deficit, which is the result of loan default on several large commercial loans originated between 2007 and 2010. In December 2015, the State Treasury stopped facilitating additional SELP lending, eliminating any potential bond funding for energy projects or access to additional capital resources. Consequently, SELP is unable to originate new loans to reduce the cash flow deficit. However, there is a continuing need for public financing options, particularly for community colleges and smaller municipalities, which represent low-risk opportunities for SELP to advance Oregon's energy agenda and strengthen SELP's financial position.

Access to project capital is an important consideration for policy makers when contemplating the role private sector projects will play in Oregon's energy future. However, private sector energy projects present a broad spectrum of capital scope and project risk that makes private projects a challenge to appropriately finance with a bond-funded program like SELP.

The Department of Energy recommends and is committed to pursuing policy options that support private sector energy project financing. This work merits a deliberate, thoughtful process that engages stakeholders and peer organizations under its own standalone work-stream.

Fiscal Impact

This concept has no fiscal impact. However, ODOE will be asking for $30 million in Article XI-J general obligation bond authority for the 2019-21 biennium. The bond authorization is required in order to provide funds for potential loans under SELP.

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