MILWAUKEE
OFFICE OF ENVIRONMENTAL SUSTAINABILITY

MEMORANDUM

TO: Common Council Members
FROM: Matt Howard and Erick Shambarger
DATE: May 26, 2011
SUBJECT: Me^2 Commercial Financing Plan for Energy Efficiency Plan

In June 2010, the City of Milwaukee and the Wisconsin Energy Conservation Corporation (WECC) were awarded $12 million from the US Department of Energy Better Buildings program as part of the American Recovery and Reinvestment Act. These funds support energy efficiency upgrades in both residential and commercial properties. On March 1, 2011, the Residential Me^2 program launched citywide.

The Office of Environmental Sustainability (OES) now seeks Common Council approval for the financing elements of the Commercial Me^2 program, consistent with Common Council file 100007. <u>OES is available to meet with any Common Council members who would like a detailed debrief or would otherwise like to discuss this approach.</u>

For Commercial Me^2, $3.85 million in ARRA funds have been allocated for "credit enhancements" to leverage private sector investment in energy efficiency in commercial buildings. <u>Federal requirements stipulate that these funds may not be given out as one time cash grants</u>. As a result, OES seeks to creatively use the allocated funds to entice banks to make loans that otherwise would not be originated due to market conditions. Further, unless the loans default, the credit enhancement can re-circulate back to the Commercial Me^2 program for additional loans into perpetuity. The concept is to have the sustainability of a revolving loan fund, but leveraged with private capital to make millions more in potential additional loans available.

Given the asset values of commercial properties and the realities of the current state of commercial banking markets and the differing needs of commercial properties depending on size, OES proposes the following multifaceted program to best meet DOE goals while providing commercial credit enhancement that are attractive and catalytic to banks and commercial property owners.

<u>Table 1: Commercial Me2 Credit Enhancements</u>

<table>
<tr><th>Target Market</th><th>Credit Enhancement</th><th>Federal Funds/Private Leverage</th><th>Financial Sustainability</th></tr>
<tr><td>Small Businesses (want simple loans)</td><td>Loan Loss Reserve to Summit Credit Union</td><td>$500,000 leverages $5m</td><td>Sustainable</td></tr>
<tr><td>Medium/Large Businesses (when property owner pays utilities)</td><td>Cash Collateral Account to bank</td><td rowspan="2">$2.85m leverages $14m</td><td>Sustainable</td></tr>
<tr><td>Medium/Large Businesses (when tenants pay utilities and property taxes)</td><td>Clean Energy Finance Ordinance, Cash Collateral to protect City Delinquent Tax Fund</td><td>Sustainable</td></tr>
<tr><td>All Qualifying Properties</td><td>Interest Rate Buy-down, in conjunction with above offerings</td><td>$500,000</td><td>Unsustainable</td></tr>
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Attachment: Detailed Breakdown of Commercial Me^2 Credit Enhancements

Attachment

Detailed Breakdown of Commercial Me^2 Credit Enhancements

Note: these options amount to "Plan B." "Plan A" would have been energy efficiency loans repaid through the We Energies electric bill, with the $3.85 million to We Energies for security against defaults, plus additional funds to We Energies for billing system upgrades. We Energies declined to participate.

Small Businesses: $500,000 to Summit Credit Union for small commercial loans up to $20,000 per project. Summit Credit Union is the City's partner for Residential Me^2. Funds would be used to create a Loan Loss Reserve across an approximately $5,000,000 (pending negotiations with Summit) loan portfolio (10:1 leverage). OES anticipates these loans would be attractive for "mom & pop" stores who want turnkey energy efficiency upgrades (eg. one-stop shopping for energy audit+ upgrade installation + financing). Sustainable, assuming limited defaults.

Goals

- ❑ Improved loan terms for energy efficiency projects such as lower interest rates, longer loan tenors.
- ❑ Financing of 100% due to program support and Focus on Energy incentives and rebates.
- ❑ Improved borrower cash flow and increased property value due to energy efficiency project benefits.

Target Market

- ❑ Businesses that lease their office space.
- ❑ Smaller non-profit organizations.
- ❑ Owner-occupied buildings with companies seeking improved building performance.
- ❑ Companies with fewer than twenty (20) employees.
- ❑ Project sizes of $5,000 to $20,000.

Features

- ❑ May be used for energy efficiency leasehold improvements.
- ❑ Favorable loan interest rates with terms out to seven (7) years depending on life of the measure installed.
- ❑ Program accessibility is dictated by verified energy efficiency savings of project.
- ❑ Low application and program maintenance fee of $100 of loan originated.

Benefits

- ❑ Credit decision is supported by program funds allocated by City.
- ❑ Streamlined underwriting procedures.
- ❑ Projects supported by Focus on Energy.

Medium/Large Businesses (when property owner pays utilitie): Larger businesses who want to work with their own bank may access the Cash Collateral Account. Commercial loans typically require a 20% down payment or property equity to provide collateral on a project. Through this offering, the 20% collateral would come from the ARRA funds, so that a property owner can take out a loan for 100% of the project costs. (5:1) leverage. $2.85 million in grant funds supports over $14,000,000 in projects. The bank would hold the ARRA funds as a deposit while the loan is being repaid. After that the funds come back to the program to support the next round of loans. The bank follows its normal procedures for reviewing the credit worthiness of the customer. In the event of default, the property owner would still be liable for collection on the loan and their credit worthiness for future loans would suffer accordingly.

Goals

- ❑ Improved loan terms for energy efficiency projects such as lower interest rates, longer loan tenors.
- ❑ Financing of 100% due to Cash Collateral Account and Focus on Energy incentives and rebates.
- ❑ Improved borrower cash flow and increased property value due to energy efficiency project benefits.

Target Market

- ❑ Commercial and Industrial businesses when owner pays utilities

- ❑ Universities, K-12 Schools and Hospitals along with non-profit organizations.
- ❑ Owner-occupied buildings with companies seeking improved building performance.
- ❑ Energy-use intensive buildings.
- ❑ Project sizes of $10,000 to $1,000,000.

Features

- ❑ Simplified master loan agreement.
- ❑ Cash Collateral Account accessible to financial institutions for debt service reserve and/or loan loss reserve.
- ❑ Cash Collateral Account is maintained at the financial institution for the life of the loan.
- ❑ Underwriting is conducted by financial institutions.
- ❑ Program accessibility is dictated by verified energy efficiency savings of project.
- ❑ Low application and program maintenance fee of 1% of loan originated.

Benefits

- ❑ New deposits to financial institutions of either $100,000 or $250,000 for initial funding of Reserve Account.
- ❑ Cash Collateral Account equal to twelve (12) months of principal and interest payments, but no more than 25% of the total loan.
- ❑ Credit decision is based on existing financial institution policies.
- ❑ Projects supported by Focus on Energy.

Medium/Large Businesses (when tenants pay utilities and property taxes): The approach for larger commercial properties where tenants pay utilities and property taxes would be to utilize the clean energy financing model, or *PACE*. Utilizing this model requires passage of a new Ordinance. Traditionally, property owners of buildings with tenants who pay the energy bills have had little incentive to pay for capital improvements that save their tenants energy, as there is not an immediate return for the property owner. To overcome this problem, OES proposes a City ordinance for "Clean Energy financing." Wisconsin statute 66.0627(8) authorizes a political subdivision to allow a private financing agreement for energy efficiency improvements, water saving improvements and renewable resource improvements to be collected as a special charge by the City. This approach allows property owners with "triple net leases" or other lease arrangements in which the tenants pay the utility bills, property taxes, and special charges to finance an energy efficiency project and pass on the savings and cost of the project directly to the tenants. The tenants are left with lower utility bills and the property owner has a more valuable building from the capital improvement.

Goals

- ❑ Provides strong incentive for property owners whose tenants pay the energy bills to undertake energy efficiency improvements in their building.
- ❑ Improved loan terms for energy efficiency projects such as lower interest rates, longer loan tenors.
- ❑ Financing of 100% due to Cash Collateral Account and Focus on Energy incentives and rebates.
- ❑ Improved borrower cash flow and increased property value due to energy efficiency project benefits.

Target Market

- ❑ Commercial and Industrial businesses when tenant pays utilities and property taxes.
- ❑ Universities, K-12 Schools and Hospitals along with non-profit organizations.
- ❑ Tenant-occupied buildings with tenants seeking improved building performance and owner seeking more valuable building.
- ❑ Energy-use intensive buildings.
- ❑ Project sizes of $10,000 to $1,000,000.

Features

- ❑ Simplified master loan agreement.
- ❑ If loan becomes delinquent the City will reimburse the financial institution through its Delinquent Tax Fund in April.
- ❑ Delinquent Tax Fund is made whole through the Cash Collateral Account
- ❑ Underwriting is conducted by financial institution.
- ❑ Program accessibility is dictated by verified energy efficiency savings of project.
- ❑ Low application and program maintenance fee of 1% of loan originated.

Benefits

- ❑ Cash Collateral Account equal to twelve (12) months of principal and interest payments, but no more than 20% of the total loan.
- ❑ Credit decision is based on existing financial institution policies.
- ❑ Projects supported by Focus on Energy.

Protection for the City: The Common Council has directed the Department of Administration to not expose the City to financial liability through the Me2 program. Under this PACE financing option, the City will receive federal funds from the "Cash Collateral Account" as a reserve to protect the City in the event of a property owner defaults on their loan payments. The legal agreement between the City, bank, and property owner will ensure that the City is not liable for any costs over and above the amount in Cash Collateral Account.

Additional Credit Enhancement for All Business Sizes: OES proposes using $500,000 to buy down the interest rate on commercial energy efficiency loans by 2-3 percentage points. This is an unsustainable use of funds, but is recommended to kick start the program and quickly get some jobs rolling. This product is for a limited time only and subject to availability. Interest rate buy down may be used in conjunction with items 1&2 above.

Goals

- ❑ Improved loan terms for energy efficiency projects such as lower interest rates, longer loan tenors.
- ❑ Leveraging of Focus on Energy incentives and rebates.
- ❑ Improved borrower cash flow and increased property value due to energy efficiency project benefits.

Target Market

- ❑ Commercial and Industrial businesses.
- ❑ Universities, K-12 Schools and Hospitals along with non-profit organizations. Funds may be used for municipal buildings if necessary to ensure funds are spent.
- ❑ Owner-occupied buildings with companies seeking improved building performance.
- ❑ Energy-use intensive buildings.
- ❑ Project sizes of $10,000 to $500,000.

Features

- ❑ The program will buy down interest rates up to 3% on approved projects.
- ❑ The product is for a limited time and is subject to availability.
- ❑ Can be used with other loan products offered through Me2.
- ❑ Underwriting and borrowing structure is conducted by financial institution selected by borrower.
- ❑ Program accessibility is dictated by verified energy efficiency savings of project.
- ❑ Low application and program maintenance fee of $500 of loan originated.

Benefits

- ❑ On a $125,000 loan with a five (5) term with a market rate of 7.00% bought down to 4% reduces borrowing costs over $12,000.
- ❑ Projects supported by Focus on Energy.

NOTE: Federal funds among these credit enhancements are expended as energy efficiency deals are made. With prior approval from the Department of Administration, the Wisconsin Energy Conservation Corporation may re-allocate the $3.85 million among the three listed credit enhancements to meet market demand for the various instruments and ensure that all funds are spent before the grant expires.

May 27, 2011

TO: Todd Conkey, WECC
Via e-mail TConkey@weccusa.org
FROM: Dan Milbrandt
Summit Credit Union

Small Scale Commercial Energy Efficiency Loans

Summit Credit Union proposes to expand our existing relationship with WECC and the Cities of Madison and Milwaukee (Me2 and Green Madison programs), to add small scale commercial applications to the current Energy Efficiency loan programs.

"Small Scale" commercial applications are defined as loans for $20,000 or less for improvements (that meet the Green Madison or Me2 criteria) to a place of business. The physical location being improved may be either owned or leased by the borrower.

Specific program requirements and guidelines are outlined in the matrix appended to this proposal. In general, loans to businesses are more individualized, and may require more time and analysis, than a loan to a consumer. Summit would, in most circumstances, expect to be able to approve a request under this program in no later than 3 to 5 business days after receipt of application documents. Those documents would be:

- Application (identifying borrower and any guarantors, amount requested, purpose, existing debts of the business
- 2 years tax returns for the business and all guarantors
    - Guarantors typically must include all individuals who own more than 20% of the business
    - Business plan, 2 years financial projections may be substituted for new/start up businesses. Verification of additional income may be required for new or start up businesses.
- Personal financial statement for all owners and guarantors
- Assessment from Energy program outlining project and anticipated savings.

The application and personal financial statement form would be available on line. Applications and supporting documents could be submitted via e-mail, fax, or in person.

Business loans at Summit are handled by specialized staff, who may not be available at all locations. Particularly in the Milwaukee market, business officers may consult with borrowers via phone conference for most follow up needs.

The following characteristics are meant to describe loans that typically would be approved—applications meeting these standards can expect approval. Debt Service and FICO scores provided are meant to be guidelines—individual analysis of applications that do not meet these standards may still lead to approval, based upon other compensating factors in the business or its guarantors.

Reporting on loans, reserve account, escrow account, and reflow account by individual program will be determined by mutual agreement, but will be based upon the reports and processes as currently established for residential loans.

Summit Credit Union's Small Business Energy Efficiency Loan Program

				Notes
Term	3 Years	5 Years	7 Years	If tenant, the lease term *may* be a factor in determining maximum loan term. Type of improvement and energy savings will also impact term
Personal Guarantee	Yes	Yes	Yes	Required on all owners in excess of 20% ownership, with the exception of nonprofits.
Debt Service Coverage Ratio (Annual Business Cash Flow divided by Annual Business Debt Payments).	>1.20x	>1.20x	>1.20x	The Debt Service Coverage Ratio is a measure of the business' ability to service debt, and we would expect that when personal income and obligations are factored in that they will not push the ratio below 1.20x.
FICO	>680	>680	>680	Credit Score based on SCU's FICO model
Common Items – Requested from Borrower	1. Completed application that includes requested loan amount, purpose, collateral offered, existing debts of the business, etc. 2. Existing Businesses - Most current two (2) years of tax returns for business and guarantors. 3. New Businesses – Copy of Business Plan, 2 Years of Financial Projections, and Verification of Other Household Income. 4. Current Personal Financial Statement. 5. Energy Assessment outlining expected cost savings.			Additional documentation may be requested by the credit union, but these are the most common items that will be needed to process the loan request.
Interest Index plus Spread	+2.00%	+2.50%	+3.00%	Prime Rate will be the index used and is subject to change.
Resulting Rate (Based on the Prime Rate as of 5/31/11)	5.25%	5.75%	6.25%	Fixed for the term of the loan.
Fees	$100	$100	$100	Flat Fee collected at closing for documentation and processing. We do not have any prepayment penalties on our loans.
LLR Secondary Loss Share %	80%	80%	80%	
Minimum Loan Amount	$5,000			
Maximum Loan Amount	$20,000			
Collateral	UCC-1 on all purchased and installed equipment GBSA (Other collateral may be requested for special circumstances, such as start up businesses)			
Required to Close	1. Establish membership with Summit Credit Union. 2. Deposit at least $5.00 into a savings account. 3. Provide information for payment set up (ACH or automatic transfers preferred). 4. Proof of insurance for collateral offered. 5. Energy Assessment /approval by program if not collected previously. 6. Loan documents signed by all borrowers and guarantors.			