NEW YORK GREEN BANK

Summary

In January 2013, Governor Cuomo called for the establishment of a $1B New York Green Bank to mobilize private sector capital to finance the transition to a more cost-effective, resilient, and clean energy system. The Green Bank will accelerate the deployment of clean energy through a variety of financing tools targeted at alleviating financial market barriers and harnessing capital markets.

The Green Bank's primary socioeconomic objectives are to:

- Increase the amount of clean energy deployed for every dollar of state money spent;
- Spur economic development and clean energy jobs across the state;
- Leverage private sector capital to develop sustainable clean energy financing markets; and
- Animate capital markets so as to reduce the cost of capital and the need for government support.

Market barriers vary across different technologies and real estate sectors, but there are a number of financing issues that are constraining private capital in the clean energy sector as a whole. For example, new bank capital requirements have sharply curtailed the already limited appetite of banks to lend in this space, particularly for smaller project sizes and longer tenor loans. Federal policy uncertainty, the absence of standardized contracts and underwriting criteria, and limited loan repayment and project performance data all further limit private sector investment in clean energy projects. Moreover, the capital markets that do exist for clean energy are underdeveloped and not widely used. These barriers limit private sector capital flows into otherwise attractive renewable energy and energy efficiency projects, creating gaps in the clean energy finance market. The Green Bank will operate on a wholesale level, partnering with intermediaries to alleviate the foregoing market barriers, thereby unleashing the flow of private capital to fill the existing clean energy finance market gaps.

In order to address these barriers, the Green Bank will follow several important operating principles:

- It will enhance total market participation by providing credit support and/or aggregation mechanisms designed to scale clean energy generation and energy efficiency projects.
- The Green Bank will partner, rather than compete, with market intermediaries — such as project developers, energy service companies, or financial institutions—that are already making progress in the market, but where that progress is constrained by the lack of availability of reasonably priced financing.
- It will look to leverage both the capital and institutional capabilities of its private sector partners.
- The Green Bank will not be in the subsidy business, but rather will earn a return on investments to preserve and grow its capital base, recycling that capital into new clean energy projects when its initial investments mature, ultimately creating a fully self-sustaining $1B support system for the clean energy finance market.

The Green Bank's long term objective is to provide a bridge to a sustainable and efficient private sector clean energy financing market. It will operate at the near-frontier—one standard deviation away from where private sector markets are functioning today. These are areas where there is market interest, but a lack of access to capital. Throughout all of its activities, the Green Bank will also collect and disseminate project and loan data, thereby improving investor confidence. Once the market sees that specific opportunities are attractive, the bank can step out of the way, leaving the private sector to take over.

Example of Green Bank Role and Potential Activity

There are economic and creditworthy solar projects for commercial and industrial properties throughout New York which are not currently financeable. Banks are not financing these deals for three primary reasons: the long loan tenor, relatively small individual project size, and the marginal investment grade of the counterparties. In the few instances where financing is offered in this sector, it is at such an exorbitant rate that the project becomes uneconomic.

The Green Bank could alleviate this financing gap through aggregation, credit enhancement and securitization. The Bank (potentially in partnership with one or more private financial institutions) could purchase commercial and industrial solar loans from intermediaries and warehouse those loans until the pool attained a volume that is of interest to the capital markets. To reduce the perceived risk of marginal investment grade counterparties, the bank could provide credit enhancement for the loan portfolio in the form of a loan loss reserve fund or a subordinated debt instrument. To address the long loan tenors, the Bank could execute a debt securitization, through which investors interested in holding long term debt, such as pension funds, could invest in longer term securities, while those banks preferring shorter loan terms would be able to exit their investments earlier. Access to the debt capital markets will allow clean energy projects to obtain financing at a lower cost of capital. [1]

Why Green Bank?

The Green Bank is a key tool that the state will employ to facilitate a transition away from an unsustainable subsidy-dependent market toward a scaled and functional private market with waning dependence on government support. New York State entities spend approximately $1.4 billion annually to incentivize clean energy. Despite this level of spending, the State is not realizing its clean energy goals. One reason for this is that approximately 80% of this amount is disbursed in one-time-use subsidies to help individual projects. For more affordable, resilient, and cleaner energy for more New Yorkers, the State needs to deploy its limited resources more strategically.

A primary advantage of the Green Bank is its ability to achieve significantly greater leverage of ratepayer funds than the one-time use subsidy/grant model. This leverage will come in several different stages. The bank's initial investments will be leveraged with private capital (which leverage levels will likely be comparable to the leverage achieved by one-time grants and incentives). But as the Green Bank's initial financing vehicles mature, the capital will be returned to the bank to be redeployed into new clean energy projects, generating another round of private capital leverage. As these cycles continue, the market will begin to achieve scale, which will reduce costs and create a virtuous system. By reducing costs and developing a track record of project and loan performance, the Green Bank will "kickstart" that sector of the market, so that it can thrive without the need for further ratepayer funding because market opportunities will prove attractive to private sector entities. This transition to a stand-alone, dependable private sector financing market produces the ultimate leverage of ratepayer dollars, at which point the Green Bank's capital base will still be available for investment in the next clean energy frontier.

[1] The bank will work in multiple areas at once. The commercial and industrial solar description was for illustrative purposes only.