Reserve Funds for Inclusive Financing

Learning Circle Series
Reserve Funds for Inclusive Financing Programs

• Why is there interest in Reserve Funds?

• Applying Structured Logic to Design a Reserve Fund

• Sample Design Profile for a Reserve Fund
Inclusive Financing Clears Barriers to Capital

▪ Conditions of persistent poverty in Southeastern states have prevented many customers from making cost effective energy efficiency investments.

▪ Consumer credit laws compel financial institutions to disqualify loan applicants that cannot demonstrate that they are worthy of credit (“creditworthy”).

▪ *Because it is a utility,* a utility can offer an opt-in tariff for cost effective energy efficiency upgrades to all customers, regardless of income, credit score, or renter status.
Why is inclusive financing vital in the Southeast?

Estimated Percent of Population in Poverty
All ages by County, 2011

Percent in Poverty
- 22.0% - 40.9%
- 15.9% - 21.9%
- 11.0% - 15.8%
- 2.9% - 10.9%
- United States = 15.9%

Note: Alaska and Hawaii not shown to scale.
More than 90% of persistent poverty counties in the U.S. are served by electric cooperatives.

Rural communities are leading the way on inclusive financing, and are offering assistance.
Inclusive Financing Clears Barriers to Capital

- Default rates for on-bill loan programs are low, yet the volumes have also been low compared to the size of the markets with access.

- Utilities with tariffed on-bill programs have reported charge-off rates that are even lower – less than 0.1%.

- Utilities in multiple states with several years of experience collectively investing tens of millions of dollars in thousands of projects have reported similar performance.

- Yet, utility decision-makers may express concerns about perceived risk, presenting a barrier to adoption that slows the rate of investment.

- Inclusive financing programs do not depend on Reserve Funds, but they can be helpful in clearing barriers to adoption.
Inclusive Financing Clears Barriers to Capital

*What does a Reserve Fund provide a utility that has financed in cost effective efficiency upgrades?*

It provides an assurance that the utility can file a claim for reimbursement for charge-offs resulting from non-payment of cost recovery charges.

For inclusive financing programs, the leverage on capital in a Reserve Fund can be very high, unleashing investment at a scale of 100X or greater.
Value of a Reserve Fund

To the Utility

▪ Address perceived risk exposure from vantage point of management / board
▪ Develop program performance data for more utilities in the state

To the Market

▪ Expand access to financing for cost effective EE upgrades
▪ Serve market segments in which customers struggle to take on debt-based financing
  ▪ Low-income, fixed income, renters, municipal governments
▪ Catalyze investment in housing and infrastructure (jobs)

For the State

▪ Increase SEO connectivity to state cooperative utilities
▪ Expand rural/low-income housing energy data set for your state
▪ Support state energy management goals
Reserve Funds for Inclusive Financing Programs

- Why is there interest in Reserve Funds?

- Applying Structured Logic to Design a Reserve Fund

- Sample Design Profile for a Reserve Fund
1. How does a utility currently handle charge-offs?

Questions for Utility Managers:

▪ What efforts does a participating utility currently take to collect payment for unpaid bills, or delinquent accounts receivable?

▪ At what point does a participating utility declare unpaid accounts receivable from a specific account to be uncollectible?

▪ How does a participating utility resolve uncollectible accounts receivable for its current service offerings, such as the delivery of energy and monthly service charges?

▪ What is the prevailing rate at which uncollectible accounts receivable on the utility’s balance sheet are charged-off each year?

▪ How does the utility currently allocate the cost of charge-offs – to all members, or only members taking service on that rate?

▪ For an inclusive financing program, is the utility willing to accept the same level of risk for unpaid collectibles that it already accepts and manages for its other investments?
2. Review experience in the field

- Among utilities that offer tariffed on-bill programs, how much have they invested?
  - Approximately $25 million

- What is the average size of investment for programs focused on whole-home residential energy efficiency upgrades?
  - $6,000-$8,000

- For those utilities whose programs are longer than five years, has the scale of risk exposure changed over the course of the cost recovery period?
  - To date, there have been no reports of risk exposure changing over time.

- Among utilities that offer a tariffed on-bill program based on the PAYS system, what is the charge-off rate reported for their investment portfolios?
  - 0.1%
2. Review experience in the field

- What are some of the causes of charge-offs that utilities with tariffed on-bill programs have reported?
  - To date, the primary cause of all utility charges claimed as charge offs have been utilities waiving tariff charges for customer service purposes. The largest charge-offs for customer service considerations resulted from bank requests during property foreclosures during the Great Recession.

- What portion of the charge-off amounts reported have been approved due to customer service considerations rather than (1) inability to collect authorized billed charges or (2) failure of equipment that cannot be cost effectively repaired given the remaining duration of cost recovery and expected life of the upgrades?
  - The majority of charge offs are attributed to customer services considerations, and to date, no utilities have reported charge-offs due to upgrade failures.
3. Financial analysis for a specific utility

- Will the energy efficiency upgrades eligible for investment through the program be based on proven technology?

- What is the estimated scale of investments a utility anticipates being sought from the market for energy efficiency upgrades?

- How large could the inclusive financing grow compared to the utility’s mainline business of electricity sales?

- Utilities that offer a tariffed on-bill program based on the PAYS system have reported a charge-off rate of 0.1% or lower.
  - If the charge-offs experienced by utilities participating in the Reserve Fund were 10X higher (1%), how much of the annual revenue expected from program cost recovery charges would be charged off each year?

- What is the estimated scale of net benefits or costs expected for the utility (based on the Utility Cost Test) from an investment portfolio of energy efficiency upgrades developed through a tariffed on-bill program?
4. Consider design attributes for a Reserve Fund

- **Deposits**: source(s) capital for the Fund and deposit with Custodian
- **Payment for Administration**: terms for cost of Fund Administration
- **Subscription**: utility sign up/allocation assigned, if applicable
- **Periodic Reporting**: data disclosure (quarterly, or semi-annual)
- **Obligation**: enrolled investments obligate Reserve Funds (actual risk exposure)
- **Claim**: process to document and submit a claim
- **Disbursement**: process to review, approve, and reimburse a submitted claim
- **Termination of Subscription**: process to withdraw from Reserve Fund
- **Dissolution**: process to transition funds out of the Reserve Fund
Reserve Funds for Inclusive Financing Programs

• Why is there interest in Reserve Funds?

• Applying Structured Logic to Design a Reserve Fund

• Sample Design Profile for a Reserve Fund
Sample Results from Framing Questions for a Reserve Fund

Roles
- Source of capital: State Energy Office ($500,000)
- Custodian: State Energy Office [or CDFI]
- Administrator: State Energy Office [or CDFI]
- Eligible Subscribers: Electric cooperatives offering inclusive financing through a tariffed on-bill program

Coverage for subscribers
- Subscription process: First come, first served
- Reporting frequency: Semi-annual
- Max. leverage: 100:1
Sample Results from Framing Questions for a Reserve Fund

**Claim coverage**
- Types of upgrades: Proven technology, cost effective at site
- Customer classes: Residential and commercial
- Claim payouts: Annual
- Order of disbursement: First come, first served
- Deductible: 0.1% of expected program revenue each year
- Max. claim: 5% of Reserve Fund = $25,000
- Max. paid to a single subscriber: 20% of Reserve Fund = $100,000

**Time frames**
- Period of availability: 5 years
- Fund termination: 17 years
Glossary for key terms

- **Tariff**: The language defining relationships and responsibilities in a tariffed on-bill program.

- **Missed Payments**: uncollectibles at locations where upgrades have been installed resulting from non-payment, partial payment, or suspended billing of program services charges relating from failed upgrades.

- **Extended Cost Recovery**: Most current tariffs for tariffed on-bill programs allow utilities to extend the duration of program services charges for missed payments if the upgrades are still functioning.

- **Subscription**: The point at which a utility agrees to the terms and conditions of participation in a Reserve Fund established by its sponsor.

- **Obligation**: An investment of capital in the field that obligates funds in the Reserve Fund to be paid out if the costs were to become unrecoverable.

- **Charge-off**: The point at which the utility has completed executing its standard protocol for collecting the balance due on past billed charges or future cost recovery.

- **Deductible**: The threshold above which charge-offs reported each year can be reimbursed with claims made to a Reserve Fund.

- **Payout**: The amount reimbursed to a subscribed utility based on a claim that funds in eligible investments had become unrecoverable.
Questions?
Office Hours:  
A benefit for Learning Circle Participants

• **NEXT SESSION:** 1-2pm EDT on Thursday, June 22\(^{nd}\)

  Call In: (641) 715-0875 / Access Code: 480411#

• Call in to take advantage of focused attention on your project or a particular line of inquiry to support your work

• Questions or topics in advance are welcome. Send them to: wholmes@seealliance.org
Beyond the Basics: Learning Circle on Inclusive Financing

1. Introduction to Inclusive Financing for Energy Efficiency
2. Update on Existing Programs
4. Due diligence with the *Decision Tool for Utility Managers*
5. Exploring Program Operator models
6. Establishing a Reserve Fund for tariffed on-bill EE programs
7. Sourcing capital for a Tariffed On-Bill investment program
8. Jobs: Workforce development in rapidly expanding EE markets
Next Session: Sourcing Capital for Tariffed OBF
Thursday, July 6, 2:00 p.m. - 3:00 p.m. EDT

- Sources of available capital
- Associated processes
- Pros and Cons
- Things to think about