Department of Energy
Washington, DC 20585

SEP PROGRAM NOTICE 10-008B
EFFECTIVE DATE (Revised): August 10, 2010
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SUBJECT: GUIDANCE FOR STATE ENERGY PROGRAM GRANTEES ON FINANCING PROGRAMS.

PURPOSE

To provide guidance to the Department of Energy's (Department or DOE) State Energy Program (SEP) grantees on financing programs. This guidance supersedes SEP Program Notice 10-008, which was issued on April 20, 2010.

SCOPE

The provisions of this guidance apply to grantees of SEP funds, pursuant to Formula Grant or American Recovery and Reinvestment Act of 2009 (Recovery Act).

LEGAL AUTHORITY

SEP is authorized under the Energy Policy and Conservation Act, as amended (42 U.S.C. § 6321 et seq.) All grant awards made under this program shall comply with applicable law including the Recovery Act and other procedures applicable to this program.

GUIDANCE

Eligibility of revolving loan funds

A revolving loan fund is an eligible use of funds under the SEP Program to the extent that the activities supported by the loans are eligible activities under the program. The implementing regulations for SEP expressly identify revolving loan funds as an eligible use of SEP funds. 10 CFR 420.18(d).

Leveraging Funds under the SEP: Purpose and Type of Leveraging under SEP

State arrangement for leveraging of additional public and private sector funds, which may include rebates, grants, and other incentives, must be arranged to ensure that federal funds go to the "purchase and installation of energy efficiency and renewable energy measures." 42 USC 6322(d)(5)(A). The leveraging of funds may be accomplished through partnerships, co-lending, and third-party administration of loans.

Loan Loss Reserves under the SEP

SEP funds may be used for a loan loss reserve to support loans made with private and public funds and to support a sale of loans made by a grantee or third-party lenders into a secondary market, subject to the following conditions. In order to ensure that a use of SEP funds to leverage additional public and private sector funds furthers the stated purposes of SEP, the activities supported by the leveraged funds are limited to those activities for the purchase and installation of energy efficiency and renewable energy measures consistent with the SEP regulations. Additionally, a grantee must ensure that the following conditions are met:

a) a grantee shall have the right to review and monitor loans provided by third party lenders to ensure that loans are being made for the "purchase and installation of energy efficiency and renewable energy measures" and comply with all conditions of ARRA funds (e.g., Davis Bacon, Buy American and NEPA) where applicable;
b) a grantee establishing a loan loss reserve has no legal or financial obligation beyond the funds committed to the reserve and is not subject to further recourse in the event losses exceed the amount of the reserve;
c) any SEP funds used to establish a loan loss reserve not used in connection with loan losses paid to third party lenders or secondary market investors must be used by or at the direction of the grantee and for an eligible use under the SEP Program, including capitalization of a RLF; and
d) under no circumstances shall SEP funds be released to a third party lender or secondary market investor for any purpose not pertaining to loan losses.

A grantee cannot use more than 50% of their SEP funds for loan loss reserves.

Interest Rate Buy-Downs

SEP funds may be used for interest rate buy-downs subject to the conditions identified in this section. An interest rate buy-down is when one party (*e.g.*, grantee) provides a lump-sum payment based on the net present value of the difference between a target return to the lender or loan investor and the borrower's interest rate. This has two primary purposes: (1) increase project affordability and demand by reducing monthly payments and (2) maintaining or increasing lender / investor interest in making loans by yielding higher returns.

In order to ensure that a use of SEP funds for interest rate buy-downs furthers the stated purposes of SEP, the loans supported by the interest rate buy-downs must be for the purchase and installation of energy efficiency and renewable energy measures consistent with the SEP regulations.

Third Party Loan Insurance

EECBG funds may be used for the purchase of third party loan insurance subject to the conditions identified in this section. Third party loan insurance is a financial arrangement whereby a third party bears some portion (or all) of a loss on a specific portfolio. This typically takes the form of a lender or investor purchasing an insurance policy from a third party against losses on a portfolio of loans up to a fixed percentage (the stop loss) of the sum of all the original loan amounts. The maximum insurance payout is determined by the value of the portfolio and not the value of individual loans.

In order to ensure that a use of SEP funds for third party loan insurance furthers the stated purposes of SEP, the loans supported by the third party loan insurance must be for the purchase and installation of energy efficiency and renewable energy measures consistent with the SEP regulations.

Obligation & Drawing Down of Funds

Loan capital

Obligation

Program funds used for an RLF are considered obligated in any of the following circumstances:

a) Receipt of a loan application from potential borrowers
b) State or local requirements (regulatory, statutory, or constitutional) dictate that funds be available in advance
c) The distribution account is operated by a third party
d) If grantee establishes and operates RLF, funds would be considered obligated by the grantee upon submitting a letter to the Project Officer and receiving a confirmation response from the Project Officer. The letter must: (1) provide the strategy for the RLF and (2) identify the scope and size of the loan program.

Draw Down

Funds may be drawn down in advance to capitalize the RLF at the time the fund is obligated. If a grantee requires a draw down under requirements "b" or "c" listed above, the grantee should document the relevant requirement and provide that documentation to their Project Officer. Any interest earned on funds which have been drawn down may be used only for program purposes. *See* 31 CFR 205.15 and 205.25; 10 CFR 420.18(d).

Expenditure

The value of loans issued in any reporting quarter is to be reported as expenditures (outlays) for that quarter.

Funds are considered fully expended when the RLF has loaned to specific borrowers for an amount equal to or greater than the SEP funds that initially capitalized the fund.

Loan loss reserves

Obligation

Loan loss reserve funds are considered obligated when they are committed as a credit enhancement to support a loan or portfolio of qualifying loans under the SEP guidelines.

For loan loss reserves supporting a new or existing Recovery Act or non-Recovery Act funded financing program operated by the grantee, loan loss reserve funds are considered obligated by sending a letter to the Project Officer indicating the establishment of the loan loss reserve.

For loan loss reserves supporting third party loans, loan loss reserve funds are considered obligated when the grantee enters into a signed agreement with the third party.

Draw Down

Once loan loss reserve funds have been obligated the funds may be drawn down from the Department of the Treasury's Automated Standard Application for Payments (ASAP) system to fund the loan loss reserve account. ASAP is the system by which grantees receiving financial assistance from DOE can draw down the funds that have been pre-authorized by the agency for payment.

Expenditure

Loan loss reserve funds are considered expended after they have met the above requirements for obligation,the grantee has drawn down funds from the ASAP system to fund the loan loss reserve account and committed funds to support individual loans or portfolios of loans. The value of funds committed to support loans in any reporting quarter are to be reported as expenditures (outlays) for that quarter.

Interest rate buy-downs and third-party loan insurance

Obligation

Funds for interest rate buy-downs and third-party loan insurance are considered obligated by the grantee once they have been committed to support a loan or loan program. These funds may be committed in any of the following circumstances:

a) Receipt of a loan application from potential borrowers
b) Where state or local requirements (regulatory, statutory or constitutional) dictate that funds be available in advance
c) When the grantee enters into a signed agreement with the third party to support an ongoing loan program with interest rate buy-downs or third-party loan insurance.

d) The distribution account is operated by a third party and the grantee enters into an agreement with the third party.

Draw Down
Funds may be drawn down at the time they are committed to an interest rate buy-down program or third-party loan insurance. If a grantee requires a draw down under requirements "a" through "c" listed above, they should document the relevant requirement and provide that documentation to their Project Officer.

Expenditure
Interest rate buy-downs and third party loan insurance are considered expended after they have met the above requirements for obligation and the grantee has funded the buy-down or insurance and should be reported as such.

Loan Defaults
Grantees are not required by DOE to replenish or replace any amounts which were lost to loan default. Loans involve risk by their very nature, so loss due to default of a borrower is an anticipated and allowable cost under an SEP grant.

"Close Out" of Financing Programs
Grantees may end or reduce funding for a RLF program, loan loss reserve program, or other eligible financing program at any time as long as any remaining funds are used by the grantee for an eligible purpose after submitting and finalizing an amendment through the Project Officer. Alternatively, the funds may be returned to DOE.

Program Income
All program income (including interest earned) paid to grantees is subject to the terms and conditions of the original grant. *See* 10 CFR 600.225(g)

Federal Requirements Applicable to Financing Programs
Generally, federal funds used to capitalize a RLF of fund loan loss reserves, interest rate buy downs and third-party loan insurance maintain their federal character in perpetuity. As a result, federal requirements that apply to the funds such as the National Environmental Protection Act (NEPA) and the National Historic Preservation Act (NHPA) would be applicable at each revolution of the RLF or on any residual funds from loan loss reserves. Federal requirements that apply to Recovery Act funds, such as the Davis-Bacon Act (DBA) requirements, Buy-American provision requirements, and Recovery Act reporting requirements would be applicable at each revolution of a RLF or on any residual funds from loan loss reserves that were funded through the Recovery Act.

The grantees who administer RLFs can expedite compliance with these statutory requirements.

NEPA

Revolving Loan Funds

If the grantee uses the SEP NEPA Template that DOE has provided to grantees to obtain categorical exclusions under NEPA, then DOE can complete a NEPA review for entire RLF programs without having to later conduct a NEPA review of individual projects.

Loan Loss Reserves

Recovery Act-funded loan loss reserves can occur in three phases:

1. DOE expends Recovery Act funds that are used to establish and capitalize a grantee's loan loss reserve account;
2. A grantee approves an application from a third-party lender requesting coverage from a loan loss reserve to support a loan or a portfolio of qualifying loans (in this case, commitment of a loan loss reserve); and
3. A grantee draws funds from the loan loss reserve account to pay third parties for the financing of privately-funded projects, in the event of a loan default.

DOE does not need to complete a NEPA review in advance of phase (1) above. However, DOE must complete a NEPA review for this loan loss reserve activity prior to phase (2) above, at the latest. To that end, DOE must complete a NEPA review before SEP grantees commit funds to cover a third-party's loans. While the requirements of DBA and the Buy American provision do not apply during phase (1), such requirements apply prior to phase (2) above. **Grantees should consider restricting their financing programs to activities for which compliance is not required under DBA (*e.g.*, including this restriction in any third-party loan loss reserve contracts).**

For instances in which grantees intend to use SEP funding for loan loss reserves supporting underlying projects that do *not* qualify for a CX determination (*e.g.*, large, commercial-scale geothermal or wind projects), DOE will typically have to complete a NEPA review for the individual proposed projects. At the time that a third-party lender applies to the grantee for coverage from a loan loss reserve, the grantee must identify the project(s) that will receive the loan. DOE will then commence a NEPA review of such project(s), which will most likely result in an Environmental Assessment or Environmental Impact Statement. A grantee cannot approve third-party loans for coverage under the loan loss reserve program until DOE completes a NEPA review for particular projects that benefit from the loan loss reserve.

Even in those instances in which DOE must complete a NEPA review for individual projects that do not qualify for a CX determination, DOE may be able to expedite the NEPA review process by using a single NEPA document for multiple, similar projects.

Also, if the total amount of Federal financial assistance (including federal funding reserved for the loss on the loan) for a project is less than 10 percent of project costs then the grantee should consult with DOE about whether DOE will have to prepare a NEPA document for the project.

For grantees that anticipate seeking approval for loan loss reserves that support projects which cannot obtain a CX determination, DOE encourages such grantees to submit a complete project description simultaneously with the third-party lender application for a credit enhancement. Otherwise, DOE may condition its approval of the loan loss reserve on a NEPA review and that conditional approval may serve as an insufficient guarantee to the lender.

Categorical Exclusions

Grantees should consider restricting their financing programs to activities categorically excluded from NEPA review (*e.g.*, including this restriction in any third-party loan loss reserve contracts).

For further information about the SEP NEPA Template, please review guidance that DOE has previously issued on streamlining compliance with NEPA. That guidance and the SEP NEPA Template itself can be found at http://www1.eere.energy.gov/wip/pdfs/nepa_program_guidance_notice_10-003.pdf and http://www1.eere.energy.gov/wip/pdfs/template_nepa_review.pdf, respectively. Further, assuming that DOE exercises no control over projects that receive loans from a RLF, DOE *may* not have to prepare a NEPA document for a project if the total amount of Federal funding for the project is less than 10 percent of project costs.

Historic Preservation, DBA, and Buy American

DOE has worked with the Advisory Council on Historic Preservation to provide States with programmatic agreements in order to streamline compliance with the NHPA requirements.

Individual homeowners receiving loans under a RLF program or supported by Recovery Act-funded credit enhancements (e.g., loan loss reserves, interest rate buy downs, third party loan insurance) would not be required to comply with the DBA. **Grantees should consider restricting their financing programs to activities for which compliance is not required under DBA (*e.g.*, including this restriction in any third-party loan loss reserve contracts)**

Similarly, the Buy American provision requirements apply to “public buildings” and “public works” and thus would not be applicable to projects performed on homes owned by individuals.

Grantee Reporting of Financial Programs

Following close of the Recovery Act award period, DOE intends to require basic reporting to confirm the funds are being used in accordance with their federal character. After the close of the Recovery Act award period, grantees with funds remaining in financing programs would prospectively be required to report basic information on the program on an annual basis until the funds are either: (1) rolled into another eligible activity and expended; or (2) fully expended through default.

Pursuant to Section 210(c) of OMB Circular A-133, third-party lenders should generally be characterized as vendors providing financial services. As such, third-party lenders (*e.g.*, commercial banks) would not be required to report any information directly to DOE. Prime grantees would retain reporting authority and would not delegate any reporting responsibility to the third-party lenders.

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