Navigating Energy Lending During Uncertainty

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Energy efficiency and clean energy lending has existed for as long as there have been beneficial energy products and practices. Long before the Inflation Reduction Act (IRA), before the American Recovery and Reinvestment Act (ARRA), and before the creation of the first green bank, lenders were providing capital to borrowers to help them afford building projects and equipment that used increasingly more efficient and cleaner energy. Policies and programs that support energy lending are important in advancing the growth of this sector, but there always has been and always will be a market for energy installations that save money, improve resilience, and bolster self-sufficiency.

Today's uncertain environment may lead some lenders to question the path forward in their energy lending journeys. Take heart in knowing that with prudent strategizing, this well-founded market can continue to offer opportunities to expand capital deployment and diversify loan portfolios while serving borrowers and their communities.

The following strategies may help provide guidance in navigating the way toward energy lending growth:

1. **Work with Your Existing Borrowers**

   Energy lending is often seen as a wholly separate line of business, which may overlap in part with your existing borrower base but may also largely consist of new customer acquisition. The truth is that many energy projects are improvements to existing buildings or business operations, or in some cases, standards and practices for new construction. If you currently offer loans for the construction or improvement of single-family residential, multifamily, or commercial buildings, you can offer financing to support energy-related installations in those same buildings.

   A homeowner interested in taking out a home equity loan or HELOC for a home improvement project may want to consider using some of the funds to incorporate more efficient HVAC or better insulation. Multifamily developers pursuing acquisition and rehab can reduce building operating costs by installing efficient lighting and heating systems. Small businesses and community facilities with tight budgets may need affordable ways of financing failing energy equipment or proactively shaving off energy costs to improve their bottom line.

Using energy lending as a customer acquisition tool is a worthwhile pursuit, but focusing in the short term on existing borrower channels can reduce the costs of expanding to a new market.

2. **Leverage Existing Loan Products and Capital Sources**
   Specialized programmatic capital designed to reduce the costs of energy lending and match energy savings streams can play an important role in expanding energy affordability. Likewise, specialized energy lending products like on-bill financing, property assessed clean energy (PACE), and energy savings agreements can help overcome customer barriers to adoption. At the same time, existing capital sources and loan products can and do support energy projects at scale and can be used to further expand energy lending activities.

   Predevelopment loans can help cover the energy-related aspects of a project, like energy audits, engineering designs, and permitting as necessary. Construction and permanent loans can support energy installations within the project scope. Home equity loans, given their strong security, often carry rates and term lengths comparable to or better than specialized energy lending products. As an alternative, traditional UCC loans can provide some degree of security for equipment-related projects, without putting borrower equity at risk.

   All of these options offer lenders perfectly legitimate ways of extending credit for energy projects without having to navigate the complexities of developing specialized energy financing products. Existing capital sources can stand behind these loans, just as they would for any other project. Furthermore, while it can be valuable to incorporate energy-saving cash flows into underwriting, the reality is that traditional underwriting factors typically far outweigh the impact of energy savings on loan performance. As long as there is recourse to the borrower, lenders can generally feel comfortable making credit decisions on the basis of strong financials.

3. **Start with Integrated Projects**
   Just as working with existing borrowers may be easier than acquiring new ones, integrating energy-related items into broader project scopes can often be easier than promoting energy technologies on their own. When lenders develop standalone financing products designed to support a new kind of asset, they typically seek to develop a deeper technical understanding of the market they are entering. This can be the case with standalone promotion of energy-related technologies, and the perceived

technical complexity is one reason lenders sometimes take longer to dive in. By contrast, when a more familiar baseline project includes a specific new feature, lenders may be more comfortable because the credit decision primarily rests on evaluating a type of project they are used to seeing.

At a basic level, lenders can simply start by tracking a few generic categories of energy-related project features, and perhaps prompting borrowers to consider them in their projects. While technical standards and approvals are certainly goals to aspire to, beginning to track energy items even using borrower self-reporting can be a key step in the right direction because it begins to integrate a culture of energy lending into the lending organization that can be built upon in the future. Some basic categories to consider tracking could include solar, battery storage, heat pumps, geothermal, insulation, LED lighting, as well as ENERGY STAR products, including HVAC, water heating, and electric appliances (products that can be quickly cross-checked against the ENERGY STAR list at https://www.energystar.gov/productfinder). Lenders may also want to add an "other" category to cover items not specifically listed out.

Including these types of items in loan proposals can also help bring the information before credit committees and senior lending staff, which may help to infuse an expectation among organizational leadership of being presented with these data as a rule.

4. **Expand to High-Demand Project Types**

   Lenders ready to expand their activities to standalone energy projects may want to start by supporting technologies for which there is already established and growing demand. In today's market, these areas could include solar panels, heat pumps, and general HVAC replacement. Lenders may also have observed demand for other technologies or project types locally or regionally within their lending footprint.

   Comprehensive, whole-building energy retrofits can be deeply beneficial to borrowers and the energy grid overall, and their larger borrowing requirements can generate additional income for lenders. At the same time, the pool of borrowers interested in pursuing these larger projects is typically much smaller than that of borrowers seeking equipment-specific loans. Even when the net economic benefits of comprehensive retrofits are projected to be higher than targeted installations, other barriers can deter borrowers, including uncertainty of savings projections, insecurity around technical information, limited capacity for project management, and potential disruption to operations.

The result is that lenders who begin their energy lending journeys by promoting whole-building retrofits may become discouraged by low demand and high customer acquisition costs.

This is not to discourage lenders who are strongly committed to supporting whole-building projects. Rather than building an entire energy lending program around these projects from the beginning, however, lenders might consider supporting whole-building projects within traditional loan portfolios, while focusing early efforts at energy-specific lending on promotion of technologies that are more likely to be sure winners. Once energy lending has gained a solid foothold within the organization, it may be easier to turn toward strategizing around larger, more comprehensive loans, as well as less common and emerging technologies.

5. **Seek Out State and Local Partners**

While uncertainty remains at the federal level, state and local partners abound. These can include state energy offices, utility energy efficiency programs, green banks and infrastructure authorities, economic development corporations, housing finance agencies, and nonprofit community-based organizations. Many local and national philanthropies also seek to promote energy-related activities, including energy lending. Some of these potential partners may be able to offer flexible capital that can be re-lent directly or blended into a capital stack to make projects more affordable. Others may be able to optimize smaller investments as credit enhancements to de-risk projects, allowing lenders to charge lower rates, extend loan terms, and expand access to credit. Still others may offer direct project rebates or interest-rate buy-downs.

There are also many existing energy lending programs in states all across the country, some of which already work with private capital partners, and others that could potentially benefit from incorporating private capitalization. Lenders interested in expanding their energy lending activities may want to consider reaching out to these programs to explore whether there may be a role for their participation. The following resources may be helpful in identifying energy financing programs within a lender's footprint:

- The **National Association of State Energy Officials (NASEO)** maintains a map of state energy loan funds, showing 37 states with such programs: https://naseo.org/state-energy-financing-programs

- The **Coalition for Green Capital** publishes a map and list of green banks by state: https://coalitionforgreencapital.com/what-is-a-green-bank/
- The **Environmental and Energy Study Institute** offers an interactive map of utilities with on-bill financing programs: https://www.eesi.org/obf/map
- **PACENation** has a map of Property Assessed Clean Energy (PACE) programs by state: https://www.pacenation.org/pace-programs/
- The national **Database of State Incentives for Renewables and Efficiency (DSIRE)** can be filtered to show financing programs by state, including general loan programs, bond programs, leasing programs, and PACE programs: https://programs.dsireusa.org/system/program

Beyond offering financial investments and participation opportunities, partners can potentially help educate lenders on aspects of energy-related projects that may be less familiar. For example, utility programs often maintain contractor lists and vetting requirements, publish approved equipment lists that can be cross-checked, have developed established methodologies for measuring energy savings, and work with third-party evaluators to review and comment on program process and to assess and verify impacts. Building relationships with these types of programs may facilitate opportunities for sharing resources.

The Bottom Line

Uncertainty at the federal level need not deter lenders from expanding to meet borrower demand for energy-related projects. Many lenders have done so already, and there exists today a robust market for energy loans. Prudent planning should always overlay growth efforts, and uncertainty can provide an impetus for thoughtful strategizing. Sensible steps forward can help lenders establish a foothold in the market, while setting them up for success as sources of capital for energy lending expand.

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