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# Memo: Options for State Administration of Qualified Energy Conservation Bonds


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#### FOR MORE INFORMATION

For additional resources and more information regarding qualified energy conservation bonds (QECBs), visit the DOE's State and Local Solution Center at [www.eere.energy.gov/wip/solutioncenter/qecb.html](http://www.eere.energy.gov/wip/solutioncenter/qecb.html) or email us at [TechnicalAssistanceProgram@ee.doe.gov](mailto:TechnicalAssistanceProgram@ee.doe.gov).

## I. Introduction

The purpose of this memorandum is to assist states in the administration of qualified energy conservation bonds (QECBs), by increasing understanding of the wide range of options and precedents.<sup>1 2</sup> As federally-subsidized debt instruments, QECBs provide state and local governments access to very low-cost financing and present a significant opportunity for states to advance clean energy in their jurisdictions. Unfortunately, a large portion of the \$3.2 billion of issuance capacity remains unused, but if a state wishes to increase deployment of QECBs, there are a number of possible administrative actions to consider.

The information in the following sections is structured to provide an overview of these administrative options and brief examples. Activities described – from the very low touch to more involved, high touch – include: authorization, notification, simple state issuances, outreach and education, waivers and reallocation, and more complex state issuances. As states look to make decisions about using their own remaining QECB allocations, as well as supporting the use of local allocations, they can use this information to consider the full range of possible actions, depending on available resources and goals.

## II. Low Touch Efforts

Two foundational, low-cost steps that State Energy Offices (SEOs) have taken to administer QECBs in their states are: 1) engaging state decision makers to authorize use of the bonds, and 2) providing basic information to local government entities entitled to QECB allocations.

### Authorization

States have authorized and officially guided the use of QECBs in two main ways: executive orders and (in rarer instances) legislation. NASEO has gathered examples<sup>3</sup> of executive orders (including Arizona, Connecticut, and Michigan) and legislation (including Colorado, Texas, and South Carolina) and found that components common to many of these documents include the following:

- Designating the agency(ies) responsible for administering the bonds and overseeing the allocation of volume caps to local governments;<sup>4</sup>
- Reviewing guidelines to ensure compliance with Section 54D of the Internal Revenue Code of 1986, which defines use of QECBs; and
- Addressing the allocation and re-allocation of volume caps to local governments.

<sup>1</sup> The information in this memo is for informational purposes only – potential issuers should consult the U.S. Department of Treasury’s QECB guidance and their bond counsels.

<sup>2</sup> For general information on QECBs, see DOE’s State & Local Solution Center QECB webpage at [www.eere.energy.gov/wip/solutioncenter/qecb.html](http://www.eere.energy.gov/wip/solutioncenter/qecb.html). This includes links to resources from NASEO and EPC, such as EPC’s periodically updated QECB status report, most recently released in December 2013 ([http://www.energyprograms.org/wp-content/uploads/2013/12/QECB\\_memo\\_12-13-13.pdf](http://www.energyprograms.org/wp-content/uploads/2013/12/QECB_memo_12-13-13.pdf)).

<sup>3</sup> Accessible at NASEO’s QECB Resources webpage at <http://naseo.org/financing-resources-qecb>.

<sup>4</sup> At least 22 SEOs have been charged with implementing QECBs.

## Notification

To support these gubernatorial or legislative actions, states have also issued notices to local governments to apprise them of their QECB allocation, inform them of the ability to waive this allocation in whole or in part back to the state, and facilitate local use of the bonds. For instance, the official notice sent from the Missouri Department of Economic Development, which houses the energy office, to the elected officials of local governments provided an explanation of QECBs as well as forms assisting the municipalities in expressing their intent to issue, reporting the results of issuing, and/or waiving back the remaining allocation of QECBs to the state.<sup>5</sup>

An important outcome of these low touch efforts is that they enable interested local governments and private issuers to access QECBs, at a relatively low cost to the state, even where there may not be an appetite at the state level to issue the bonds.

## III. Medium Touch Efforts

States looking to achieve greater impact in the use of QECBs have taken some or all of the following additional steps: 1) overseeing and conducting issuances with the statewide pool, 2) educating potential issuers and project developers (including state entities, local governments, and businesses, and 3) instituting a waiver process. Although these efforts increase the state time and resources necessary for QECB administration, they also lead to significantly greater benefits, achieved through qualified clean energy projects.

### Issuing State Allocations

Many states have opted to issue QECBs themselves, capitalizing on the large opportunity within state and local buildings to implement capital improvements to increase efficiency. Issuances are simplest and most common for “projects in need of money” within the state (i.e., deferred maintenance projects that reduce energy consumption in public buildings by 20%). States like Kentucky and Maryland, among others, have found particularly large opportunities in schools and universities, which account for approximately one-fourth of known QECB issuances.

For many energy efficiency projects in the MUSH market, project finances and repayment are typically clear, and bond investors are generally comfortable with the underlying credit of the state issuer. As a result, these types of projects are the most common usage of QECBs and avoid placing a heavy administrative burden on the state or municipal issuer. As of 2012, EPC data indicate that the vast majority (nearly 90%) of issuances stayed below the IRS-designated threshold for administrative costs, which allows issuance costs of up to two percent of bond size. To ease the administrative burden, SEOs also commonly partner with a state bonding authority.

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<sup>5</sup> View Missouri’s letter at [www.naseo.org/Data/Sites/1/documents/committees/financing/resources/qecb/MO\\_QECB\\_Notice\\_of\\_Intent.pdf](http://www.naseo.org/Data/Sites/1/documents/committees/financing/resources/qecb/MO_QECB_Notice_of_Intent.pdf)

## Outreach & Education

By delivering marketing and education to local governments and other potential QECB issuers, the state can help reap the benefits of subsidized energy financing, without necessarily adding to its own debt ledger (which occurs, for instance, when the state issues the bonds itself). The energy office in Maryland, the Maryland Energy Administration (MEA), has functioned as an important coordinator between local energy offices and financing entities with bond authority. MEA has organized meetings and sessions to bring these different groups of stakeholders together around QECBs, which has helped to generate demand and increase awareness of the bonds.<sup>6</sup>

## Waivers & Reallocation

An option exercised in several states is to establish a waiver process, by which local governments can return their sub-allocations to the state, which can then potentially reallocate the QECBs for use. To date, at least 34 states have instituted a waiver process. These processes can be put in place in several different ways (e.g., Executive Order, legislation) and may be designed in a number of ways, including “affirmative” waivers and “constructive” (sometimes referred to as “claw back”) waivers. It should be noted that waiver processes have had varying success depending on their design and implementation. Particularly where a state relies on affirmative waivers, they may want to consider coupling that effort with outreach and education.<sup>7</sup>

To reallocate QECB volume caps that have been waived back – or to allocate state volume cap – some states have instituted a competitive solicitation. For this greater level of effort, states are able to better align local QECB usage with their own objectives. For example, the energy office in Tennessee has released a request for proposals (RFP) to assess potential projects, which would adhere not only to Internal Revenue Service (IRS) provisions for QECBs, but also to the Office of Energy Programs’ economic development and efficiency goals.<sup>8</sup>

Ultimately, although outreach and waiver processes require greater involvement, the positive outcome of this level of effort is demand generation for and ultimately greater use of QECBs – not only from state and local agencies but also from private businesses. For instance, Massachusetts navigated a waiver and competitive solicitation process to ultimately facilitate over \$10 million of private activity QECB issuances (accounting for three of the six known issuances to date of this type).<sup>9</sup> Several states, including Colorado and California, have successfully used outreach and waiver processes, to deploy all or a large portion of their states’ total QECB allocations, in a time period of just a few years.

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<sup>6</sup> View “Making it Easier to Complete Clean Energy Projects with Qualified Energy Conservation Bonds” webcast hosted by DOE, in February 2013, at [http://www1.eere.energy.gov/wip/solutioncenter/webinar\\_archives.html](http://www1.eere.energy.gov/wip/solutioncenter/webinar_archives.html).

<sup>7</sup> For more detailed information on waiver/reallocation options, view the latest version of EPC’s QECB status report at [http://www.energyprograms.org/wp-content/uploads/2013/12/QECB\\_memo\\_12-13-13.pdf](http://www.energyprograms.org/wp-content/uploads/2013/12/QECB_memo_12-13-13.pdf).

<sup>8</sup> View Tennessee’s RFP at [http://www.tn.gov/environment/docs/energy/tn\\_qecb\\_rfp\\_20131028.pdf](http://www.tn.gov/environment/docs/energy/tn_qecb_rfp_20131028.pdf).

<sup>9</sup> For more information on Massachusetts’s QECB issuances, see <http://financing.lbl.gov/reports/qecb-mass.pdf>.

## IV. High Touch Efforts

QECB issuances generally become more complex and resource-intensive for the issuer when used for projects and programs with which bond market investors are unfamiliar. Special attention, expertise, and partnerships are required to ensure the project and bond finances are appropriately structured with respect to the underlying credit and repayment streams associated with the project or program. Although these issuances are time- and resource-intensive, they present several advantages for states, including: funding more sustainable programs (particularly in the case of financing programs) and completing projects and programs that are tailored to a state's priorities and needs, rather than just a quick and easy option.

Among the most complex known usages are Green Communities Programs, which are recorded to have been established in four states (Missouri, California, New York, and Colorado) and account for a small portion of QECB issuances. The multimillion dollar QECB issuance orchestrated by the New York State Energy Research and Development Authority (NYSERDA), in August 2013, highlighted the particular complexities, level of effort, and resources and expertise needed to use QECBs to this end. The bonds were used to support a residential energy efficiency loan program (through Green Jobs-Green New York), which proved to be unfamiliar territory to rating agencies and bond investors. To receive a reasonable rating on the bonds, NYSEDA worked with the state's Environmental Facilities Corporation and U.S. Environmental Protection Agency (EPA) to gain approval to use the Clean Water State Revolving Fund as a guarantee. This required NYSEDA to make tweaks on the basic bond structure in order to make it suitable for capital markets.<sup>10</sup> Ultimately, this issuance required a high level of effort, but it enabled NYSEDA to raise \$24.3 million in support of residential energy efficiency financing within the state.

## V. Conclusion & Accessing Technical Assistance

There is no "right answer" when it comes to QECB administration. Each state will need to determine what level of effort is right for them, given their goals and available resources, but with the wide range of approaches available, QECBs can be a viable option for advancing clean energy in all states.

To connect with other states that have used or are interested in using QECBs, and/or to access one-on-one technical assistance from the DOE, NASEO, and EPC team, please contact Eleni Pelican at 202-586-4922 or [eleni.pelican@ee.doe.gov](mailto:eleni.pelican@ee.doe.gov) or Sandy Fazeli at 703-299-8800 or [sfazeli@naseo.org](mailto:sfazeli@naseo.org).

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<sup>10</sup> View a suite of documents developed over the course of NYSEDA's August 2013 issuance (including: energy office's letter of intent and board resolution to issue QECBs, exchanges with EPA regarding the use of the State Revolving Fund for energy efficiency loans, official statement, indenture of trust, guarantee agreement, and tax certificate) at <http://naseo.org/financing-resources-qecb>.