CLIMATE CABINET EDUCATION

Memo: Green Banks

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Why States Should Experiment With Green Banks

Beginning with Connecticut in 2011, state and local governments began establishing public and quasi-public financial institutions known as 'green banks' to help support state climate policy objectives. Green banks exist to drive public and private investment toward projects that reduce greenhouse gas pollution through clean energy deployment, energy efficiency, transportation infrastructure, and more. They also exist to fill 'financing gaps,' making projects like solar rooftop installations more attractive to investors and more affordable for consumers.

In 2022, Congress took action to support green banks through the passage of the Inflation Reduction Act (IRA), often hailed as the most significant piece of climate change legislation ever passed in the United States. The IRA foregrounds strategic public investment meant to transform how the country produces, transmits, and consumes energy by building public and private capacity in key sectors and coordination among them.

Within the IRA is the Greenhouse Gas Reduction Fund (GGRF), a $27 billion commitment to fund "green banks" and other investment vehicles. The GGRF offers the potential to catalyze state and local green investment by capitalizing green banks and other qualifying investment vehicles, which will then use the GGRF money to support greenhouse gas mitigation projects in their regions.

The GGRF has the potential to be transformative for the state public green bank landscape. According to the American Green Bank consortium, lending through green banks totaled $7 billion from 2011-21, which is equivalent to the amount of money that the GGRF sets aside for grants through its Solar for All program alone.

Designing Green Banks To Be Effective

Mindful of the fact that the GGRF money had the potential to supercharge what states were already doing with respect to green lending, the authors of the legislation that inspired the GGRF included a provision for a "startup division" that would carry out technical assistance to encourage and support entities without a green bank to create one. It is critical that the spirit of this provision not be lost in implementation. States with existing green banks and states considering establishing new ones should seize this opportunity to use federal funds to maximize how effective and useful these bodies are. Technical capacity and commercial infrastructure should build over time as GGRF fund recipients, including public and private investors, use recycled public investment funds to continue to further push public and private investment towards better environmental outcomes.

In addition to serving as a signature climate achievement, the IRA is often hailed as evidence of a "rebirth of industrial policy." In fall 2022, Boulder County, Colorado published a memo containing recommendations for how state and local governments should design green banks to ensure that they are building state capacity for the long-term. Among the principles articulated in that memo:

- Robust public investment and a process for establishing a long-term investment strategy
- Diverse, inclusive, and decentralized governance
- High degrees of public accountability
- Strong labor standards
- Strong environmental justice provisions

The recent establishment of the Minnesota Climate Innovation Financial Authority (MNCIFA) most closely aligned with the green bank principles enunciated in Boulder County's "green bank" memo. In addition to Minnesota, many states took action toward securing GGRF resources. In 2023, nearly all states applied directly for GGRF funds, and numerous states saw action to establish green bank-like entities, including New Mexico, Massachusetts, and Wisconsin.

Maximizing Federal Support for Green Banks

The Center for Public Enterprise (CPE) has described several ways that green banks can maximize the degree of support that they receive from federal infrastructure packages: by qualifying for the IRA's 'elective pay' program and by taking advantage of provisions in the Infrastructure Investment and Jobs Act (IIJA) enabling them to access Department of Energy Loan Program Office funds.

Elective Pay (also known as Direct Pay)
CPE explains the impacts of elective pay in its September 2023 Elective Pay Financing report:

> *"The elective pay provision of the Inflation Reduction Act stands to transform public power. Tax-exempt entities—including state instrumentalities and nonprofits—can now claim tax credits for investment in or production by clean power facilities and receive tax credit disbursements directly from the Internal Revenue Service (IRS). Applicable entities include existing public power organizations, rural cooperatives, economic development corporations, departments of energy, or housing authorities. Tax credit eligibility puts public power on a more even footing with private developers and allows states and localities to seriously consider owning and operating their own facilities rather than defaulting to procurement via power purchase agreements (PPAs) with private providers.*
>
> *Elective pay directly from the IRS not only promises to reshape the landscape of energy financing by providing public entities with comparable investment advantages to those of private counterparts, but cuts out tax equity investors, allowing public entities to capture the full value of their tax credits. Utilizing elective pay for public power beckons states, municipalities, and agencies to re-imagine their roles in leading and facilitating project development. Public actors must develop the capabilities to plan capital projects, procure financing, operate complex energy systems, and manage project portfolios...."*

To accompany that report, CPE created a financial model quantifying how much eligible developers can earn in elective payments, and in its report it made sure to describe how green banks fit into its model:

> *"Green banks typically act as revolving funds…and lend alongside private investors to take on subordinated debt positions in projects, thus lowering their overall costs of capital. The CPE model gives green bank debt a lower interest rate than market rate debt by default, but users can customize this input. (In the absence of an official green bank, other state- and local- level financial institutions can play the role of one.) ….*
>
> *The IRA, which upgraded the Environmental Protection Agency (EPA)'s Greenhouse Gas Reduction Fund (GGRF) into a seed fund for various public and non-profit green lenders, has the potential to expand green banking nationwide. The GGRF can fund both state-based institutions and national non-profits. There are various ways for green banks to make use of elective pay. Pending federal rulemaking, green banks can potentially purchase investment and production tax credits from private and public developers and monetize them in a procedure referred to as "chaining." CPE is monitoring regulatory guidance on the eligibility of green banks to engage in chaining transactions and has recommended allowing such practices be taken in conjunction with other elective pay tax credit entities to maximize the uptake of elective pay wherever possible."*

Carveouts in Loan Programs Office (LPO) Financing Facilities to co-lend with Green Banks

CPE explains how private and public developers that receive green bank financial support can access highly concessional LPO financing in their December 2023 issue brief on the "SEFI Carveout":

> *"The Infrastructure Investment and Jobs Act (IIJA) and the Inflation Reduction Act (IRA) have turned the Department of Energy's Loan Programs Office (LPO) into the catalyst for a massive buildout of new energy investment. Under its original Title 17 authority, the LPO was limited to providing credit to borrowers working with experimental technology. But a new carveout in the IIJA and the IRA extends that credit authority to nearly any kind of energy project, so long as it's being co-financed by what's called a State Energy Financing Institution (SEFI). This SEFI carveout enables the LPO to tap its*

> *$40 billion loan guarantee authority to augment state government investment in a wide range of clean energy generation and energy efficiency programs. The LPO can team up with a designated SEFI—a state agency such as a green bank, infrastructure bank, or a financing board with a climate-related mandate—to offer a concessional loan and loan guarantee to energy project developers (financial supports referred to here as "Title 17 financing"). When the LPO is co-investing alongside state agencies, it no longer needs to restrict its Title 17 financing authority to developers of innovative, not-yet-commercialized technologies. Because such a wide variety of greenhouse gas-reducing projects are now eligible for support under the SEFI carveout, the LPO essentially becomes the nation's green bank, anchoring investment in all kinds of strategic energy and decarbonization projects by allowing states to sidestep risk-averse private investors and save vital projects."*

Already, nine quasi-public state institutions have been deemed eligible for the SEFI carveout.

To be sure, the LPO has imposed a restriction on project developers "double dipping" into distinct federal funding pools. A developer that receives Title 17 financing cannot also receive loans and grants through other federal programs like the GGRF. CPE has written:

> *"SEFIs that receive federal support at an organizational level (e.g. as the recipient of GGRF funding) do not trigger the LPO's prohibition on double-dipping so long as federal funds are not used to directly or indirectly support projects receiving an LPO loan guarantee. The LPO said in its webinar that its guidance on these provisions was not finalized yet. It is not yet clear how the LPO would treat, for example, a borrower receiving a loan from a third-party institution that received a GGRF grant. CPE will stay informed on this particular edge case."*

Green banks seeking SEFI designation and GGRF funds simultaneously should be conscious in their construction of financing programs to meet state-level decarbonization and energy development targets to ensure that the project developers they support do not break "double dipping" rules by taking support funded through GGRF provisions while also applying for LPO financing.

Importantly, projects receiving LPO financing can still make use of elective pay or tax credits, whichever they are eligible for.