

Over the past decade or so, policymakers, utilities, energy efficiency advocates, and others have worked to deliver financing for energy efficiency improvements in the commercial, residential, and institutional sectors. While many efforts have relied on public dollars, in recent years the private sector has shown an increased interest in engaging in this market (Rockefeller Foundation and Deutsche Bank 2012; Freehling 2011). The Rockefeller Foundation and Deutsche Bank estimate that private-sector entities could invest more than \$279 billion in energy efficiency across the buildings sector. Yet aside from investment in the federal and public sectors, actual growth in energy efficiency activity has been slow over the last few years and has yet to reach the scale of these impressive estimates.

Small to mid-size lenders are well positioned to help realize the full market potential of energy efficiency, particularly with small commercial customers. While larger financial institutions are playing a growing role in serving small businesses (Bank of America 2014), small to mid-size local lending institutions may offer some advantages to energy efficiency customers: they can connect borrowers to local resources like contractors, and they understand similar local projects. Further study may show that energy efficiency can become an important market niche for small lenders, sustaining their position in local markets.

Many entities have entered the market for energy efficiency lending, including Community Development Financial Institutions (CDFIs), mission-driven green lenders, local community and regional banks, credit unions, small commercial entities linked through utility programs (e.g., Northeast Utilities' MassHeat loan program), and a handful of commercial entities and conventional local banks that are exploring the marketplace independently. Each type of lender may have a distinct motivation for exploring this space. For example, CDFIs may be driven by their mission to deliver financial services to underserved markets. Local commercial entities may anticipate that small commercial buildings within their communities will need energy efficiency improvements to meet building code requirements.

On October 18, 2013, the American Council for an Energy-Efficient Economy (ACEEE) and Energi Insurance Services, with support from the National Renewable Energy Laboratory (NREL), Argonne National Laboratory, and the U.S. Department of Energy (DOE) convened a group of key stakeholders to discuss opportunities for augmenting small bank and lender activity in the energy efficiency space.

This white paper captures key findings from the convening and places them within the context of current research and experience. It goes on to make recommendations to entities within the energy efficiency community to help increase small to mid-size lender activity in the market for energy efficiency financing.

Before the convening, ACEEE and Energi identified four key groups of obstacles and asked attendees to specify barriers they faced within these categories:

- Origination and demand
- Cash-flow validation
- Financial regulatory and reporting requirements
- Documentation and structural elements

Our discussion revealed the following points.

Lack of customers. By far the greatest obstacle identified by participants is a lack of customers actively seeking financing for energy efficiency investments. Lenders shy away from the energy efficiency market because they remain unconvinced that there is sufficient demand to justify their investment. One lender noted that in the commercial market, in particular, building owners, managers, and tenants need to be sold on the value of energy efficiency as an investment.

Our convening identified the following hindrances to demand for energy efficiency investments: perception of high transaction costs, competition with other investments, a lack of education on the availability and cost/benefit of energy-efficient products, and a lack of marketing for incentives. As a partial solution, benchmarking and disclosure of energy efficiency will likely play a role in driving future demand, and integrated program approaches offering a one-stop shop for customers may also be beneficial. However more insight is needed into how to change reactive customers into proactive customers. Growing the market for energy efficiency requires more than the availability of innovative products and lenders willing to lend. It requires a customer base. If customers are motivated to take advantage of the economic benefits of energy efficiency, efforts to expand offerings from small and mid-size lenders could be a stepping stone to a large-scale efficiency market.

Lack of standardized validation metrics. For efficiency loans to be a viable product at scale, both lenders and potential borrowers need to have confidence that projected energy savings will be realized. Participants in the convening frequently mentioned the need for validating energy savings to catalyze demand in both residential and commercial subsectors, but no consensus emerged on how to provide it. On the commercial side, cash flow is harder to validate as it is outside the scope of appraiser analysis. Documented good management of the building is a key indicator of whether a commercial customer will be a dependable steward of the loan.

Two schools of thought emerged on the importance of energy savings cash flows and associated underwriting practices. While some participants felt that security on energy savings cash flows makes a material difference, others insisted that energy savings cash flows are of minor importance. Delving more deeply into these two schools of thought may help us understand what is required to catalyze market activity.

Regulatory hurdles. Attendees offered insights on regulatory and reporting hurdles they faced in developing new lending products due to the evolving financial regulatory landscape. Several cited the culture of risk aversion in the regulatory world resulting from the financial crisis. It was noted that distrust between regulators and rating agencies poses a significant challenge. However attendees were also familiar with methods of risk assessment that that could help push loan products along, even in a risk-averse climate. In any case, we should engage financial regulators to familiarize them with the characteristics and benefits of energy efficiency lending products, and to help them develop safe, sound, and effective products.

Development and deployment of underwriting standards. Finally, several participants noted that many localized programs try to reinvent the standards wheel instead of complying with national best practices. This may be due to a lack of awareness around current best practices.

Program designers and lenders need technical assistance. Possible vehicles include technical toolkits, continued meeting of the attendees as a working group, development of a larger SLEEC network, a document drop-box, and data sharing among working group members.

The energy efficiency community should collaborate with various types of small to mid-size lenders to encourage future market activity. Engaging customers is the most important piece of the puzzle. We should help lenders develop attractive products, particularly for traditionally underserved and challenging markets such as small commercial and multifamily customers.