

**Biennial Report**

**State of Oregon  
Department of Energy**

**Small Scale Energy Loan Program**

**Finances: July 1, 2008 through June 30, 2010**

**Loan Activity: Through December 31, 2010**

**Prepared for Governor Kitzhaber  
and the 76<sup>th</sup> Oregon Legislative Assembly  
pursuant to ORS 470.140(2)**

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## **Oregon Department of Energy Small Scale Energy Loan Program**

In 1979, the legislature created the Small Scale Energy Loan Program (SELP). In 1980, voters approved an amendment to the Oregon Constitution authorizing sale of general obligation bonds to finance small scale, local energy projects. SELP made its first loan in 1981.

SELP's purpose is to promote energy conservation and renewable energy resource development. Renewable resources include solar, geothermal, biomass, hydro, wind, and waste heat. SELP also can fund projects that use alternative fuels, save transportation energy, make projects from recycled material, or those that increase the production of efficiency or extend the operating life of a project. The projects must meet local community or regional energy needs in Oregon and must save or produce reasonable amounts of energy compared to the project's cost and type.

SELP serves individuals, businesses, non-profit organizations, Oregon state government agencies and local government municipalities, schools, tribes, and agencies of the federal government.

The program often makes loans that conventional lenders will not make. In some cases, conventional lenders lack the technical expertise to evaluate a project. In other cases, SELP's tax-exempt rates or long-term, fixed-rate loans make a project economically viable.

The program is designed to be self-supporting. While the sale of bonds provides loan funds, borrowers pay the costs of administering the program through loan repayments. The SELP staff includes loan officers, accountants and an energy analyst.

### **Bonds**

Article XI-J of the Oregon Constitution limits the amount of State of Oregon general obligation bonds that may be issued and outstanding at any time to one-half of one percent (0.5 percent) of the true cash value of taxable property in the state. The Department of Revenue determines the market value of all nonexempt real and personal property in the state as of January 1 each year. As of January 1, 2009, the true cash value of all property in the State was approximately \$499 billion. As of December 31, 2010, approximately \$222 million principal amount of SELP bonds were outstanding, leaving approximately \$2.3 billion of authorization remaining under Article XI-J.

For the 2009-11 biennium, SELP has authority to issue up to \$250 million in general obligation bonds. As of December 31, 2010, SELP had issued \$87 million and had \$163 million of legislatively approved bond issuance authority remaining for the biennium ending June 30, 2011. SELP is on schedule to issue approximately \$27 million in March 2011 to fund new energy conservation and renewable energy projects. The remaining biennial authority appears adequate to meet expected demand.

SELP issues three types of bonds:

- Governmental Purpose, for energy projects in publicly owned and operated facilities.
- Private Activity, for projects that use renewable resources to produce energy or for energy projects for non-profit organizations.
- Federally Taxable, for energy-saving projects in homes and businesses.

Governmental purpose and private activity bonds are tax-exempt and therefore provide lower interest rates than taxable bonds. Municipal and school borrowers can use tax-exempt financing as long as the facility is publicly owned and operated.

Private activity bonds may fund any facility type built by any type of borrower. However, according to federal tax law, private activity bonds can fund only renewable resource generation and qualified non-profit conservation projects. Applications for these projects must be processed and approved before bonds are sold.

## **Loans**

*Loan terms* vary. In general, terms are set to match the term of the bonds that funded the loans. The loan term may not exceed the expected project life.

*Loan interest rates* are set at the bond rate plus a spread that allows for the program to recover its costs and factors related to loan risk, generally between 1.00-3.50 percent. This differential pays for the costs of issuing bonds, funding reserves for loan losses, and operating the loan program.

*Loan size* can range from \$25,000 for residential projects, to several hundred thousand dollars for schools, to millions of dollars for industrial and energy-generation projects. SELP's largest loan to date is a series of credit lines of up to \$97.5 million with the Oregon University System to finance various campus deferred maintenance projects. Approximately \$76.8 million has been disbursed for efficiency related upgrades to buildings at all seven university campuses. SELP's current largest non-state agency loan was \$17 million for the construction of a hydroelectric generation facility in Deschutes County, which was placed into service in October 2010.

*Loan fees* are based on the amount of the loan request and the approved loan amount. For example, the application fee is 1/10 of 1 percent of the loan request (maximum \$2,500) and the loan fee is 1 percent of the final loan amount. Application forms contain an explanation of fees in greater detail and are available on the Oregon Department of Energy website <http://www.oregon.gov/ENERGY/LOANS/selphm.shtml>.

*Loan security* may be a first or second mortgage on project land, buildings and equipment. Additional collateral such as land, assignments of income, trust deeds, and other assets also may be pledged, concurrent with loan guarantees. Some lands under leases and contracts can qualify as security. Equipment and the borrower's pledge to make payments serve as security for municipal and state agency borrowers.

## **Program Procedures**

SELP markets energy loans with reasonable interest rates and favorable fixed rate terms. Upon application, SELP staff review all projects to determine eligibility for financing based on statutory requirements, and perform a detailed financial analysis of the energy project and the borrower. Loan officers will review general project economics, value of security, credit information, financial status, loan risk and projections of stability and worth. The SELP energy analyst provides a thorough review of project feasibility and ability to provide the required energy savings or income stream. Staff recommends loan approval based on the soundness of the energy project and the borrower's ability to repay. SELP's citizen advisory committee must review loan applications over \$100,000 (\$500,000 for state agencies). The committee reviews loan requests in a public meeting and makes recommendations for the approval or denial of each loan.

Processing time varies with the size, type and complexity of each application. Small municipal and commercial loans may be approved in two to three weeks. Larger commercial or industrial loans, which must be reviewed by the advisory committee, may take 60 days or more. For large, complex projects, processing time may take several months. Loans financed with private activity bonds can take more than 90 days due to additional public hearing requirements imposed by federal tax law. Through pre-application meetings, customers are able to submit all necessary information with the application to avoid unnecessary delays.

Upon loan approval and closing, SELP monitors project completion. Throughout the life of the loan, SELP verifies insurance coverage and monitors compliance with loan terms and borrower financial strength. SELP reviews the financial statements of major borrowers annually to verify the borrower's continuing financial stability.

## **Program Accomplishments**

As of December 31, 2010, SELP has financed 828 projects totaling an aggregate of \$540 million upon final disbursement. These projects save or produce substantial energy savings each year.

In addition to loans made, SELP has counseled many potential borrowers regarding energy project design or financing plan improvements. Viable projects that are not good candidates for SELP loans were referred to private financing sources. Likewise, private lenders refer borrowers to SELP. Occasionally, applicants with approved SELP loans ultimately borrow from private lenders.

Between January 1, 2009 and December 31, 2010, SELP made 33 loans totaling \$96.3 million, of which \$71.1 million has been disbursed.

Below are examples of projects financed during that period:

### *Public Sector Loans:*

The Oregon University System borrowed \$65 million for energy projects at several campuses. Portland State University borrowed \$33 million for the upgrade of equipment and systems and energy efficiency retrofits at Lincoln Hall, Science Building 2 and the central heating and cooling facility which includes utility distribution tunnels throughout campus. Western Oregon University borrowed \$4.8 million for measures that improve energy efficiency and updating systems at the Health and Wellness Center in the Physical Education Building and the Humanities and Social Science Building. Oregon Institute of Technology borrowed \$1.8 million for the energy systems related to the renovation of Owens Hall. Eastern Oregon University borrowed \$3.6 million related to critical energy efficiency upgrades to Inlow Hall. University of Oregon borrowed \$7.2 million for the replacement and modification of equipment and systems within the Central Power Station to improve efficiency and capacity to serve new buildings and future campus development. An additional \$6.3 million will be loaned to the campus during the spring and summer 2011 to finish the improvements which include a turbine generator and heat recovery boiler. Oregon State University borrowed \$6.8 million to retrofit Nash Hall and \$1.4 million will be spent on energy efficiency upgrades to Education Hall.

A vast majority of campus building renovations are being built to Leadership in Energy and Environmental Design (LEED) certification standards. In addition, the deferred maintenance retrofit projects undergo a review by the State Energy Efficiency Design (SEED) program. The program ensures that cost-effective energy conservation measures are included in all new and renovated public buildings and are constructed to exceed Oregon state building code energy conservation standards by at least 20 percent, saving the state millions of dollars in energy costs.

In addition to state agency loans, SELP loaned \$285,000 to the Astoria School District to install a high efficiency boiler and other cost-saving energy measures and controls at Astoria Middle School. The school is expected to pay the debt service on their loan with the resulting energy savings and the use of their share of the annual Senate Bill 1149 funds collected as a public purpose charge from consumers within the PGE and PacificCorp service territories.

A loan for \$17 million was made to the Central Oregon Irrigation District (COID) to fund an irrigation canal piping and 5.0 MW hydroelectric generation facility on the Pilot Butte Canal in Deschutes County. The project is unique in that it couples a water restoration project, increasing water flows in the Deschutes River, with renewable energy generation. The project was commissioned and started generating power in October 2010.

### *Private Sector Loans:*

SELP continued to make a significant contribution to the local agricultural industry in the form of loans totaling more than \$267,000 to various privately owned fruit orchards in Hood River and Wasco counties. Funds were used for wind machines and propane heaters to provide frost protection for cherry and pear crops. Wind machines work to bring the warmer air aloft nearer to the surface to raise the temperature in the orchard to protect the fruit from freezing. The machines also dry the fruit during heavy rains to prevent splitting and spoilage. The wind

machines and heaters replaced oil or smudge pots used to protect over 150 acres of fruit. In addition to the diesel fuel savings from the orchard wind machines, they have the added benefit of reduced air pollution; labor savings associated with orchard maintenance; and reduced product loss.

SELP loaned more than \$2.8 million for the installation of solar photovoltaic (PV) systems on 11 existing commercial and residential buildings in Lane, Multnomah, Marion, Deschutes, Jefferson and Wheeler counties. The solar arrays combined to produce over 400 kilowatts of power generation, and in some cases, use locally produced PV panels. While the financial payback is traditionally longer than the term of the associated loans, borrowers are motivated by their desire to generate renewable energy and decrease dependence on fossil fuels.

EasyStreet Online Services, Inc. borrowed \$4.5 million from SELP to expand and improve the energy efficiency of its current data center in Beaverton. Conservation measures include improved efficiency of the HVAC system that cools the facility servers and other efficiency measures that reflect the company's commitment to the environment. EasyStreet's more energy efficient infrastructure will give them a competitive advantage as energy costs continue to rise and the use of data centers increase in nearly every sector of our economy.

SELP loaned \$2.25 million to an LLC owned by the Bill Naito Company to make energy efficient renovations to the Montgomery Park Building in northwest Portland. The project included upgrades to the existing HVAC system and more efficient lighting. The facility improvements reflect the company's sustainable renovation practices which focus on refurbishing their buildings using environmentally conscious designs.

During 2009 and 2010, SELP loaned more than \$500,000 to various property owners in Multnomah and Lane counties for energy conservation projects. Most of these loans were for energy efficiency upgrades to multifamily rental complexes and industrial buildings. Windows and patio doors were replaced with more energy efficient ones; and in some instances also included improvements to heating and cooling systems and upgraded lighting. These upgrades provide added benefits of improved comfort and reduced utility costs for the occupants and reduced facility maintenance and increased property value for the building owners.

## **Financial Highlights**

These financial highlights are drawn from the SELP financial statements for the periods ending June 30, 2009 and June 30, 2010:

For the period July 1, 2009 through June 30, 2010, the program earned \$17.5 million in interest on loans and investments. Interest expense for the period was \$15.6 million.

Expenses for the period were \$1.7 million for personal services compared to \$1.5 million for the period July 1, 2007 through June 30, 2008. Services and supplies were \$936,000 compared to \$850,000 for the previous biennium. SELP developed a database through the Department of Administrative Services Information Resources Management Division (IRMD) to provide essential accounting, billing and reporting functions for the loan program. The system was

placed into service in 2004 and provides improved data integrity and reliability replacing unstable and outdated software in use since 1991.

As of June 30, 2010, there were 247 loans outstanding, totaling \$161.4 million. Individuals, businesses, non-profits and municipalities owed the program \$103.8 million and \$57.6 million was due from state agencies. Cash and investments related to the SELP program totaled \$36.2 million on June 30, 2010. Article XI-J Bonds payable at June 30, 2010 totaled \$188.6 million.

On June 30, 2010, the program had \$26.5 million, or approximately 17 percent, of its loans outstanding in hydroelectric generating facilities. One of those projects with a loan balance of approximately \$8.2 million was strained by drought conditions because of their location in the 1990s and again in recent years. Conditions tend to be cyclical and should improve much like they did in previous years, enabling the borrower to make significant progress in restoring their loan payment reserves.

In addition, SELP has identified and is monitoring seven additional borrowers experiencing financial difficulties due to challenges presented by the current economic climate and various other operational factors. These borrowers represent 11 loans aggregated at approximately \$23 million, or 15 percent of total outstanding loans on June 30, 2010.

Of the under-performing loans in the portfolio, five were operating under agreements to forbear against issuing notices of default in exchange for temporary modifications of their payment terms. SELP expects a majority of these borrowers to work through their current challenges and does not anticipate significant losses in long-term cash flows as a result.

Prior to the \$17 million hydroelectric loan made in 2010, SELP's largest loan was made in 2007 for \$20 million to the largest ethanol production facility on the West Coast. The borrower filed a voluntary Chapter 11 bankruptcy petition in the beginning of 2009 and converted to Chapter 7 proceedings later that year. The project was liquidated in December 2009 with \$3 million dispersed among six lenders. On June 3, 2010, SELP wrote off the \$18 million balance on the loan. Prior to this write-off, SELP experienced a relatively low loan loss rate at less than 0.50 percent of total loans made by the program to date. While the bonds used to finance the loan are secured by the general taxing authority which may be levied against taxable property within the Oregon, the state has not imposed property taxes for many years to pay outstanding bonds. Currently the program is using existing reserves to pay the debt service on the outstanding bonds associated with the loan and believes that improved loan underwriting standards and loan volume should continue to provide cash flow to make the bond payments. In the event that loan repayments and other resources available to SELP are not sufficient to pay debt service on the bonds, management anticipates that the state will use its general fund to pay the bonds or use other resources to loan funds to SELP for the bond payments.

Current cash flow projections indicate that SELP will have sufficient funds to meet its semi-annual bond payments and pay administrative expenses in the next five to seven years without additional infusion of cash. Program loan loss reserves appear to be adequate for the next biennium.

Article XI-J of the Oregon Constitution and ORS Chapter 470 established two accounts for SELP funds. They are the Small Scale Local Energy Project Loan Fund (Loan Fund) and the Small Scale Local Energy Project Administration and Bond Sinking Fund (Sinking Fund). Proceeds of general obligation bonds issued under Article XI-J are held in the Loan Fund until disbursed to borrowers. Repayments of loans funded by the Loan Fund and interest earnings are held in the Sinking Fund. Amounts in the Sinking Fund pay for costs associated with the issuance and management of outstanding bonds, bond debt service and administrative costs of SELP.

As of June 30, 2010, the cash and investments of the two SELP funds were as follows:

**SELP Cash and Investments**  
(As of June 30, 2010)

	Cash	Investments
Loan Fund	\$11,261,500	\$0
Sinking Fund		
Borrowers Reserve Accounts	1,532,089	
Program Account	9,357,269	
Arbitrage Rebate	0	
Bond Principal and Interest Account	8,507,319	
Extraordinary Expense Account	5,541,701	
Fiscal agent cash	0	
Redemption Account	0	
<b>TOTAL</b>	<b>\$36,199,878</b>	<b>\$0</b>

The 75<sup>th</sup> Legislative Assembly created the Energy Efficiency and Sustainable Technology Program (EEAST) through House Bill 2626. EEAST provides authority to finance residential and commercial energy efficiency and renewable energy projects by allowing consumers to repay energy loans as a line item charge on their monthly utility bill. SELP received lottery bond proceeds to carry out the EEAST pilot program in May 2010. EEAST is expected to be implemented statewide in 2012.

EEAST provisions amended ORS Chapter 470 establishing the Loan Offset Grant Fund and the Supplemental Fund. Lottery bond proceeds and any other funds directed by gift, grant or donation to the EEAST program is deposited into the Loan Offset Grant Fund. A one-time energy resource supplier assessment (ESA) transfer of \$300,000 was deposited into the Supplemental Fund to pay for the administrative costs to set up the EEAST program.

As of June 30, 2010, the cash and investments of the two EEAST funds were as follows:

**EEAST Cash and Investments**  
(As of June 30, 2010)

	Cash	Investments
Loan Offset Grant Fund	\$5,003,700	\$0
Supplemental Fund	186,146	
<b>TOTAL</b>	<b>\$5,189,846</b>	<b>\$0</b>

**Bonds Issued**  
(July 1, 2008 through June 30, 2010\*)

Type	Amount	Purpose
Governmental Purpose	\$39,295,000	New loans for energy-saving and energy generating renewable resource projects in private and public sectors.
Private Activity	16,430,000	
Federally Taxable	3,525,000	
<b>Total</b>	<b>\$59,250,000</b>	

\*\$43,015,000 Governmental Purpose and Taxable bonds issued July 29, 2010.