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Groups: 501(c)(3) Bonds a Useful Tool for Financing Clean Energy Projects.

WASHINGTON - Qualified 501(c)(3) bonds are a financing tool that can be used to increase nonprofits' clean-energy infrastructure and reduce their energy expenditures, the Clean Energy and Bond Finance Initiative said in a recently released paper.

The initiative, known as CE+BFI, was formed by the Council of Development Finance Agencies and the Clean Energy Group.

Qualified 501(c)(3) bonds can finance energy-efficiency or renewable-energy installations for nonprofit facilities. They are issued by state and local government entities, and their proceeds are loaned to nonprofit borrowers. The bonds are repaid by revenues of the nonprofits, and in some cases some of the debt service can be paid from the money the nonprofits save on their utility bills as a result of the clean-energy improvements, according to the paper.

At a webinar Thursday, Jason Rittenberg, CDFIA director of research and advisory services, said that his group felt it was important to discuss 501(c)(3) bonds because a lot of the types of clean-energy projects that have been done by state and local governments through bond financing can similarly be done by nonprofits through 501(c)(3) bond financings. He noted there are fewer restrictions for 501(c)(3) bonds than other types of private-activity bonds, and data recently provided to Congress shows that most PABs are 501(c)(3) bonds.

"The flexibility and established investment reputation of this financing tool will encourage the spread of retrofits, installation of renewable energy infrastructure, reduce energy expenditures among donation-dependent nonprofits, and contribute to state and nonprofit clean energy goals," CE+BFI said in the paper.

Nonprofits who have used 501(c)(3) bonds to finance clean-energy projects include Loyola University in Chicago, which used the bonds to finance facilities with energy saving features and Elmhurst College in Illinois, which used bonds to finance a student housing facility that achieved Leadership in Energy & Environment Design silver certification and a green surface parking lot. World Wildlife Fund also used the bonds to finance construction of its 'green headquarters' in Washington D.C.

One benefit to using these bonds for clean-energy projects is that they make marginal projects financially feasible, since bonds offer borrowers low interest rates over long periods of time. Another benefit is that investors are already familiar with 501(c)(3) bonds, so there would be a market for bonds of good quality. And 501(c)(3) bonds are repaid by revenues of the borrower, rather than by public funds as is the case with general obligation bonds, the paper pointed out.

"Bond financing can allow an organization to complete an eligible project sooner, at a larger scale, and with more favorable terms than would be feasible through capital fundraising efforts or other financing tools," CE+BFI said. "Financing large projects through 501(c)(3) bonds also frees up cash flow in the short term to serve other purposes, providing the borrower greater flexibility in financing its operations."

There are many potential projects that could be financed with 501(c)(3) bonds, because nonprofit facilities are common across the county and both new and older buildings could benefit from improvements that reduce monthly energy expenditures. Additionally, a single issuance could finance improvements for multiple facilities or nonprofit organizations.

“Whether combining multiple improvements to a single, large facility or pooling retrofit projects among several nonprofit owned facilities, 501(c)(3) bonds can scale clean energy investments to a considerable degree,” CE+BFI said.

The paper notes there are some limitations to using this type of financing. One limitation is that qualified 501(c)(3) bonds offer little cost benefit to smaller projects as a result of the administrative costs of structuring transactions, according to the paper.

Also, nonprofits have to demonstrate that they will be able to use future revenue to pay debt service, the paper said. Private, detailed assessments would need to be conducted to make sure the projects would produce enough cost savings to support repaying the bonds.

Further research should be done to determine whether energy cost savings equal to or greater than monthly debt service would serve as an acceptable credit enhancement, and what the potential is for issuers to collaborate to finance large-scale projects across a wide geographical area, CE+BFI said.

by Naomi Jagoda MAY 29, 2014 4:08pm ET