**The National Rural Electric Cooperative Association is concerned that efforts by RUS to develop and implement a project finance program will be counterproductive to RUS’s and USDA’s efforts to support rural development.** Availability of reliable, reasonably priced power has proven time and again, in the United States and throughout the world, to be the backbone of economic growth and development. Lower consumer density and lower load factors in rural areas drive the cost of electric service higher than in urban areas. Providing electric service requires large amounts of capital; the low interest rate financing RUS provides to rural electric cooperatives is essential to their ability to provide reliable power at reasonable rates.

To date, the Rural Electrification Act (the “REAct”) has successfully supported the electrification of the rural United States using a system-wide lien finance structure under which borrowers that are load serving utilities pledge their entire electric systems as security. As noted in the ANPR, the current default rate for the REAct electric loan and loan guarantee programs is less than 1%. Default rates and losses due to default since the inception of the REAct program in 1936 have been extremely low. As a result, REAct loans and guarantees receive a negative credit subsidy under the Federal Credit Reform Act – which makes the entire amount of budget appropriations each year available to be advanced to borrowers, rather than portions of appropriations being used to cover credit subsidy costs.

**Project finance lending done by RUS will be significantly more risky than the utility system lien lending it has been doing with electric cooperative borrowers.** Credit ratings of electric cooperatives that have obtained ratings are on average well above the investment grade thresholds (typically A or A-). In a recent study, Moody’s Investors Service found that the 10-year cumulative default rate for all types of project finance bank loans was similar to default rates for low investment grade/high speculative grade (BBB-/BB+) corporate issuer credits.[[1]](#footnote-1) Further, the Moody’s study reports that the average default rate for United States electric power industry project finance loans originated between 1983 and 2011 was 11.3%.

**Appropriations and calculation of the credit subsidy for any RUS project finance program should be done separately from appropriations and credit subsidy calculations for RUS’s traditional utility system lien program financing.** If appropriations and credit subsidy calculations are not done separately, the amount of financing RUS can provide to support delivery of reliable, reasonably priced power in the rural United States will be eroded, due to the higher risk profile of project financing as compared to the traditional utility system lien structure employed by RUS. To achieve the same level of basic funding in support of the rural electric service that is provided today, and is a necessary precursor to further rural development in the United States, Congress will need to appropriate more tax dollars for each dollar of investment in basic rural electric infrastructure.

**An RUS project finance program will require a significant increase in direct costs for increased staffing and outside consultants.**  Project finance lending requires lenders to have substantial technology specific expertise, and perform significantly more due diligence for each loan than utility system lien lending. Investor-owned utilities raise equity and debt capital in the private capital markets based solely on general disclosures about their assets, financial performance and future plans. RUS currently provides financing to its borrowers based on reviews of general information provided by the borrower regarding the project being financed, and projections of the borrower’s future financial performance. In contrast, project finance lenders require independent engineering assessments, evaluate credit of project off-takers, evaluate credit and experience of major project contractors, enter into consent agreements with offtakers and major project contractors and implement cash sweeps and waterfalls.

**RUS’s already limited staff does not have the capacity or the necessary experience to develop and implement a project finance program.**  When renewable energy facility development first began in the United States, most US commercial banks did not provide project financing because they lacked the relevant expertise and experience – most project financing for renewable energy was done through US branches of European banks, which had developed experience due to the earlier development of renewable energy in Europe. Even now, the number of commercial banks that provide project financing in the renewable energy arena is limited. RUS staff is currently overwhelmed with the work required to implement its existing financing programs, and is undertaking to streamline its regulations to eliminate unnecessary regulatory oversight so that staff can focus efforts on only matters necessary to manage its successful utility system lien lending operation. Currently, RUS has over700 current borrowers to monitor and provide financing for. Even after streamlining efforts are completed, the current RUS staff will be fully occupied in managing its existing programs and borrowers.

The recent experience of the Department of Energy in implementing its project finance program under Sections 1701 and 1703 of the Energy Policy Act of 2005 is instructive. To implement that program, DOE hired numerous outside consultants with substantial project finance experience, and engages Wall Street law firms with substantial project finance experience for all projects. The borrowers pay significant application, loan origination and maintenance fees to DOE to cover DOE’s costs, and also pay the fees and expenses of DOE’s outside counsel. NRECA is concerned that under current circumstances, it is unlikely that RUS can obtain the additional appropriations needed to hire enough staff with the appropriate experience to develop and manage a project finance program.

**RUS’s current borrowers do not need an RUS project finance program, and an RUS project finance program is not needed to support the development of renewable energy.** RUS’s borrowers are able to achieve lower financing costs by borrowing on a fully secured, utility system lien basis. RUS borrowers can use existing RUS programs to finance renewable energy facilities, and private developers of renewable energy facilities have other federal and state governmental supports available to them that make development of renewable energy projects economically feasible.

In addition to the general comments above, NRECA offers the following observations in response to some of the questions posed in the Project Finance ANPR:

**Under what conditions should section 317 authorities be used? Are there any legislative impediments to utilizing the authority on an ad hoc or programmatic manner?**

RUS can use the Section 317 authority to make loans on a utility system lien, secured basis for 100% of the costs of renewable energy projects without undertaking an analysis of the extent to which power from the project will serve rural consumers. This would allow all current and former RUS borrowers to obtain 100% RUS financing for renewable energy generation projects, regardless of whether the borrower was a borrower in June 2008 and the extent to which the borrower’s service territory includes urban areas.

In designing a project finance program, RUS would need to consider the expiration date of appropriations made for the program. Construction lenders for projects will need to have a commitment from RUS as the long-term take out lender, subject to customary conditions, before advancing on the construction loan. If the construction period is long, or there are delays in construction, unless the appropriation that supports RUS’s commitment to lend can be available until expended, appropriations could be lost due to construction delays.

**If the RUS were to expand its project financing authority, especially for renewable energy investments, what infrastructure should be eligible for project finance program loans? What entities should qualify for project finance program loans?**

The REAct mandates that RUS give preference to “States, Territories, and subdivisions and agencies thereof, municipalities, people’s utility districts, and cooperative, nonprofit or limited-dividend associations”. 7 USC § 904(a).Nothing in Section 317 or any other section of the REAct changes this basic preference. Therefore, in implementing all of its financing authority, including authority under Section 317 and in implementing any project finance program, RUS must give preference to electric cooperatives and these other governmental entities.

Under a project finance program, RUS should only finance projects that are using proven technologies already in commercial use in the electric utility industry in the United States. RUS should use underwriting standards similar to those used by commercial banks that provide project financing. Even with such standards, so long as tax credit and other supports for renewable energy projects remain in place, RUS should expect that its project finance program will attract they types of projects that current project finance lenders will not fund – essentially, the more risky projects.

RUS would need to carefully consider the requirements for considering loan applications under a project finance program to be complete. For renewable energy projects in particular, many more projects are considered by developers than are ever completed. Transmission owners and operators receive, and study, generator interconnection requests for many more projects than ever materialize. RUS would need to conserve its limited staff resources for only those projects that have cleared significant development hurdles, so that RUS staff is not diverted to performing the substantial amounts of due diligence required for a project financing on projects that are never completed.

**Is there interest in seeking a project finance program loan from the RUS under its existing financing authority or Section 317?**

As noted above, NRECA is not aware of any significant level of interest among its members for obtaining loans from RUS on a project finance basis. Occasionally NRECA members find it advantageous to hold certain assets in separate entities, but in most circumstances they are willing to fully back the performance of the separate entity, either through a guarantee or a “take or pay” power purchase arrangement. The existence of the guarantee or “take or pay” power purchase arrangement ameliorates most, if not all, of the project finance risk inherent in making a loan to an entity that owns only one asset and has only one customer.

If there were significant interest in RUS developing a project finance program, we expect that RUS would know about it. Nothing in the REAct prevents RUS from lending to entities that are not its traditional borrowers, or mandates the utility system lien financing structure RUS has been implementing as the sole financing structure available to RUS. If the traditional RUS borrowers had interest in obtaining project financing from RUS, they could have requested it. Section 317 of the REAct was enacted in 2008, and RUS has not been overwhelmed with requests for loans from renewable energy project developers that have projects that serve both rural and urban customers, but need financing in a project finance basis.

**What type of credit support, in addition to power purchase agreements, are available to secure the government’s interest and ensure a long term revenue stream to repay project finance program loans? What credit criteria can be built into the credit structure to ensure the repayment of project finance program loans?**

There are well established mechanisms that project finance lenders use to maximize the probability of repayment in full of their loans, and RUS should implement those same mechanisms in any project finance program it creates. They include lockbox arrangements to sweep all of the project company’ cash and disburse it in accordance with an established waterfall, debt service and O&M reserve funds, perfected liens on all of the project company’s assets, mortgagee’s title insurance on all real property, a long-term offtake agreement with a creditworthy entity, equity contribution agreements from creditworthy equity holders in the project company, consent and waiver agreements between the lender and the project offtaker and the major project contractors (e.g. construction and O&M providers).

However, the best assurance a lender obtains regarding repayment of a project finance loan comes through the diligence it performs on the project before making the loan. The credit support provided by liens and consent agreements with project offtakers and the other items mentioned above are all designed to provide a fallback if the project does not perform as planned. In the project finance context, the ultimate success of the loan relies most heavily on the ability of the developer to construct and operate the project in a manner that will allow it to fully perform under the long term offtake agreement, and the ability of the offtaker to perform its obligations. RUS will need to engage in substantial due diligence with respect to the experience and creditworthiness of the project developer, the construction contractor, the major equipment provider, the O&M provider, and the creditworthiness of the offtaker and the offtaker’s need for the power from the project over the term of the offtake agreement. RUS will need to engage an independent engineer to evaluate and report on whether the project has been constructed in accordance with the construction contract and is capable of meeting the requirements of the offtake agreement. RUS will need to evaluate whether the project company has obtained all the regulatory approvals and permits needed to construct and operate the project, and whether the offtaker has obtained all regulatory approvals needed to perform its obligations.

**Would borrowers accommodate a take or pay power purchase agreement equivalent with a component where RUS will always be paid?**

If by “always”, RUS means in all circumstances, regardless of whether the facility performs in accordance with the requirements of the offtake agreement, the answer is that it is highly unlikely a project owner will find an offtaker that will essentially agree to guarantee the project owner’s RUS loan. PPA pricing typically is designed to cover debt service, operating costs and provide a return on investment to the project owner. The project owner controls decisions regarding construction, operation and maintenance, and the offtaker is willing to pay a premium over what its costs would be if it built and operated the project itself in return for the project owner taking the risk of project performance.

Facilities that have capacity value and are dispatchable often are contracted for under PPAs with a capacity payment and a separate energy payment. The capacity payment is designed to cover fixed costs (including debt service and return on investment) and is payable regardless of whether or how much the offtaker calls on the facility. Even so, the amount of the capacity payment due is typically reduced in some proportion to the amount of time that the facility was not available to run, and in some proportion to the facility’s failure to achieve a specified heat rate. Some offtake agreements put the obligation to procure fuel on the offtaker, in which case the project owner does not have risk of having its capacity payments reduced due to lack of fuel. Capacity pricing would likely have to include very little return on investment to entice an offtaker to agree to pay the owner’s debt service costs regardless of whether the facility performs as required.

Renewable energy projects that rely on intermittent energy sources like wind or solar energy are not dispatchable and thus typically do not have sufficient capacity value to merit PPA pricing that includes both a capacity payment and a separate energy payment. PPAs for these projects typically include only a price for delivered energy, and require the offtaker to pay for “deemed delivered” energy if the offtaker asks that the facility be curtailed during a time when energy from the facility was otherwise available. Here too, to entice an offtaker to agree to pay amounts to the project owner sufficient to cover debt service, regardless of how much energy is delivered, would require extremely low PPA pricing which would yield very little return on investment to the owner.

In conclusion, NRECA urges RUS to continue to focus its efforts on supporting rural development through streamlining the operation of its existing electric loan programs. Maintaining reasonably priced, reliable electric service throughout the rural United States relies upon continued support from existing, low cost RUS loan and loan guarantee programs. Section 317 of the REAct can be implemented through loans on a utility system lien secured basis to current and new or returning RUS borrowers. There is no need for RUS to increase its risk profile by implementing a project finance program, for which it does not have the requisite staff or experience. Recent experience shows that the addition of numerous staff and consultants with project finance experience won’t necessarily prevent spectacular loan defaults in an electric project finance program. Project financing by RUS would add to RUS’s overall costs, without providing commensurate benefit to rural development. The RUS loan programs have put United States taxpayers’ dollars to work in an efficient and highly effective manner - a project finance program that is not needed to achieve RUS’s mission would only serve to harm RUS’s overall effectiveness.

1. Special Comment entitled “Default and Recovery Rates for Project Finance Bank Loans, 1983-2011”, issued by Moody’s Investors Service, dated February 4, 2013. [↑](#footnote-ref-1)