Focus Series

OREGON ON-BILL FINANCING PROGRAM

On-Bill Financing Brings Lenders and Homeowners on Board

Better Buildings Neighborhood Program partner Clean Energy Works (CEW) (formerly known as Clean Energy Works Oregon) partnered with Craft3, a nonprofit community development financial institution, to offer low-interest, on-bill financing of home performance upgrades in Oregon to create a new market for financing energy efficiency that resulted in an unprecedented number of upgrades in a short period of time.

Through this effort, CEW was able to create a level of demand for loan products that sparked the interest of other financial institutions, even without the program's incentives. Over a three-year period, the program facilitated more than 3,200 home energy upgrades.

In December 2013, CEW and Craft3 completed a groundbreaking $21 million loan portfolio sale from its residential program to the secondary market, which will provide the necessary liquidity for program sustainability. Following is an abridged transcript of interviews with CEW Vice President of Strategy and Market Development Scot Davidson, CEW Chief Financial Officer Shirley Cyr, CEW Director of Marketing Stephanie Swanson, and Craft3 Executive Vice President Adam Zimmerman.

What market barriers were preventing lending for energy efficiency upgrades?

Cyr (CEW): Following a decline in the market value of houses in the late 2000s, homeowners faced barriers to borrowing against the equity in their homes for energy efficiency projects. As for lenders, one of the main barriers was that they were unfamiliar with energy efficiency upgrades and weren't seeing these projects as something quantifiable. We partnered with Craft3 to offer an on-bill loan product that allowed consumers to repay loans through their primary utility bill, which enhanced accessibility to energy efficiency upgrades by making it easier and more convenient for homeowners to pay back the loan.

Zimmerman (Craft3): The average homeowner in the late 2000s looking to invest in energy efficiency work would have been lucky if their bank had someone to discuss home equity lines or consumer credit lines with them. There is also the issue of driving demand for energy efficiency improvements so that the market grows to be large enough for lenders to consider energy efficiency lending as a serious part of their business line. The barrier here is that a smaller market can put energy efficiency lending on the margin for some credit institutions.

How did on-bill financing help lower barriers to entry and drive demand?

Swanson (CEW): On-bill financing was a real game-changer with regards to accessibility and affordability of upgrades. Homeowners might have had reservations when presented with project costs, but when coupled with rebates and on-bill repayment, a $12,000 project cost suddenly becomes a very reasonable monthly payment, somewhere between $35 and $100 a month. People plan their home finances in terms of monthly payments, and on-bill financing brings the affordability of upgrades into focus.

How did CEW recruit other financial partners?

Cyr: We approached Craft3 in the early stages of our program and found that as a community development financial institution, it shared our mission and was willing to participate in the program as a lender. We also successfully approached Umpqua Bank about participating, as it had a green lending program that was likewise compatible with our program. Outside of the Portland, Oregon, market, we focused on recruiting community credit unions, whose focus is on growing their members. This was really successful, and the result was that other lenders learned about the program and started asking us about participating.

What motivated lenders to participate in the program?

Zimmerman: During the recession in the late 2000s, we found that banks were not lending and construction projects for small contractors were drying up. For Craft3, our mission as an organization is to create community resilience, by supporting programs that create employment and consumers that make choices that strengthen communities. Similarly, when the City of Portland received stimulus money, a number of voices in and around the city wanted to make sure that money spent on this new energy efficiency program would create employment. As a result, the city ultimately developed a community workforce agreement with goals around employee wages and creating employment for a more diverse range of people. When CEW was created, this agreement was incorporated into its mission. Craft3 has been doing work related to job creation and access to capital for women and minorities, in addition to environmental work, for its entire history. It was apparent that the CEW program was right in line with what we have always cared about.

Davidson (CEW): There is a pretty significant relationship between mission alignment and success. This was the case for Craft3 and CEW, but also for finding a way to work together with our other lenders. For example, our largest commercial lender has a marketing interest in green lending, and mission alignment with the credit unions we worked with came from their nature of having a high service orientation to their members.

Cyr: Lenders also saw this as a way of acquiring customers, and they were encouraged by the fact that we ensure good results for homeowners by completing a quality inspection at the end of each project. The quality of the loans, which had low default rates, was another factor that motivated lender participation. Then, once they were part of our program, most of our lenders offered loan products to our customers at below-market rates, which created a competitive environment where they all knew what the others charged.

How did you transition away from offering credit enhancements?

Cyr: We started out with loan loss reserves, which are a pool of money that provides risk protection against bad loans, for all of our lenders, but we had the opportunity to work with one lender, Umpqua Bank, that did not require them. They wrote the loans to the normal standard, as unsecured loans, and we found that they were willing to participate without credit enhancements. As our program proved itself successful, more lenders were willing to follow suit, with SELCO Federal Credit Union and Advantis Credit Union joining without loan loss reserves or loan origination fees. They saw that losses had been very limited and that these were really good borrowers. Although eliminating credit enhancements makes some lenders hesitant to lend to customers with lower credit ratings, Craft3 has gone beyond the norm by loaning to lower credit score consumers who have a clean utility bill history.

How have you kept lenders engaged after eliminating credit enhancements?

Davidson: The market has matured to a point where loan loss reserves are not necessary. We have competitive rates and readily available capital in the credit unions and commercial banks, as well as through Craft3. Our main challenge is customer acquisition. In Oregon, we have a greater supply of lenders than we do customer demand. Because we find that there is not sufficient volume of demand to satisfy all lenders who are interested in the program, we have focused on working more closely with the lenders we have, rather than increasing the lender base.

How were you able to attract investor interest in purchasing your loan portfolio?

Zimmerman: Craft3's success working with CEW to offer homeowners on-bill energy efficiency financing motivated us to pursue selling our residential loan portfolio, which would both reduce our risks and help us to obtain funding to address future program demand. The investor that we attracted (Self-Help Credit Union) is a credit union; they are liquid in terms of cash available for investment, and they are also a community development financial institution. They were mission-aligned, had liquidity that they needed to invest, and had experience that made them aware of regulatory issues and the expected terms of loans like this. We found that they were also willing to learn more about CEW's customers, contractors, and on-bill financing.

Davidson: I think that investors become interested when loan volume reaches a certain level of scale. We hit a level of scale that allowed for secondary market transaction, in large part because of demand generation supported by American Recovery and Reinvestment Act (ARRA) money. (ARRA is the federal stimulus package President Obama signed in 2009 to spur economic activity, create jobs, and invest in long-term growth.) The trick for CEW is to drive customer demand for energy efficiency services, which benefits the markets involved with contractors and lenders, as well as climate goals.

What advice would you give other programs interested in adopting an on-bill financing model?

All:

- **Make the business case for the lender.** Create convincing arguments around how your program benefits both lenders and customers, and consider the best ways to communicate the broader benefits of energy efficiency work, such as climate goals and job creation.
- **Work more closely with a limited number of lenders.** More lenders can mean more maintenance, as well as increased difficulty maintaining a consistent level of service. In addition, a smaller number of lenders allows for better communication.
- **Find an early adopter with a similar mission.** As the first lender in the CEW program, Craft3 inspired confidence for other lenders to join. Mission alignment is important to successful partnerships; Craft3 and CEW had an obvious alignment, but in all cases, finding common ground facilitated collaboration.
- **Conceptualize program costs in terms of monthly payments.** Although customers are price-sensitive on the surface, once they start to see payments and savings, they become less preoccupied with rates. On-bill financing benefits from the fact that customers largely think of their finances in terms of monthly payments.

For more information, feel free to contact Shirley Cyr at shirley@cleanenergyworksoregon.org.