Department of Energy
Washington, DC 20585

SEP PROGRAM NOTICE 10-008D
EFFECTIVE DATE (Revised): October 26, 2012
ORIGINALLY ISSUED: December 7, 2009

SUBJECT: GUIDANCE FOR STATE ENERGY PROGRAM GRANTEES ON FINANCING PROGRAMS.

PURPOSE

To provide guidance to Department of Energy (DOE) State Energy Program (SEP) grantees on financing programs. This guidance supersedes SEP Program notice 10-008C which was issued March 14, 2011.

SCOPE

The provisions of this guidance apply to grantees of SEP funds, pursuant to Formula Grant or American Recovery and Reinvestment Act of 2009 (Recovery Act).

LEGAL AUTHORITY

SEP is authorized under the Energy Policy and Conservation Act, as amended (42 U.S.C. § 6321 et seq.). All grant awards made under this program shall comply with applicable laws including, but not limited to, the SEP statutory authority (42 U.S.C. § 6321 et seq.), the Recovery Act (Pub. L. No. 111-5) and 10 CFR 420 and 600.

GUIDANCE

Eligibility of Revolving Loan Funds

A revolving loan fund (RLF) is an eligible use of funds under the SEP Program to the extent that the activities supported by the loans are eligible activities under the program. The implementing regulations for SEP expressly identify revolving loan funds as an eligible use of SEP funds. 10 CFR 420.18(d).

Leveraging Funds under SEP: Purpose and Type of Leveraging under SEP

Grantee arrangements for leveraging additional public and private sector funds, including rebates, grants, and other incentives, must be implemented to ensure that federal funds go to support eligible activities under SEP (i.e., those activities listed in 10 CFR 420.15 and 10 CFR 420.17, subject to the limitations in 10 CFR 420.18). The leveraging of funds may be accomplished through mechanisms such as partnerships with third-party lenders, co-lending, third-party administration of loans, and loan loss reserves (LLRs).

Loan Loss Reserves under SEP

SEP funds may be used for a LLR to support loans made with private and public funds and to support a sale of loans made by a grantee or third-party lenders into a secondary market, subject to the following conditions. In order to ensure that a use of SEP funds to leverage additional public and private sector funds furthers the stated purposes of the SEP Program, the activities supported by the leveraged funds are limited to those activities that are eligible activities under the SEP regulations. Additionally, a grantee must ensure that the following conditions are met:

a) a grantee shall have the right to review and monitor loans provided by third- party lenders to ensure that loans are being made for the "purchase and installation of energy efficiency and renewable energy measures" and comply with all conditions of Recovery Act funds (e.g, Davis Bacon, Buy American and National Environmental Policy Act (NEPA)) where applicable;
b) a grantee establishing a LLR has no legal or financial obligation beyond the funds committed to the reserve and is not subject to further recourse in the event losses exceed the amount of the reserve;
c) any SEP funds used to establish a LLR not used in connection with loan losses paid to third-party lenders or secondary market investors must be used by or at the direction of the grantee and for an eligible use under the SEP Program, including capitalization of a RLF; and
d) under no circumstances shall SEP funds be released to a third-party lender or secondary market investor for any purpose not pertaining to loan losses.

A grantee cannot use more than 50% of their SEP funds for LLRs.

Interest Rate Buy-Downs

SEP funds may be used for interest rate buy-downs subject to the conditions identified in this section. An interest rate buy-down is when one party (*e.g.*, grantee) provides a lump-sum payment based on the net present value of the difference between a target return to the lender or loan investor and the borrower's interest rate. This has two primary purposes: (1) increase project affordability and demand by reducing monthly payments and (2) maintaining or increasing lender / investor interest in making loans by yielding higher returns.

In order to ensure that a use of SEP funds for interest rate buy-downs furthers the stated purposes of SEP, the loans supported by the interest rate buy-downs must be for the purchase and installation of energy efficiency and renewable energy measures consistent with the SEP regulations.

Third-Party Loan Insurance

SEP funds may be used for the purchase of third-party loan insurance subject to the conditions identified in this section. Third-party loan insurance is a financial arrangement whereby a third party bears some portion (or all) of a loss on a specific portfolio.

This typically takes the form of a lender or investor purchasing an insurance policy from a third party against losses on a portfolio of loans up to a fixed percentage (the stop loss) of the sum of all the original loan amounts. The maximum insurance payout is determined by the value of the portfolio and not the value of individual loans.

In order to ensure that a use of SEP funds for third-party loan insurance furthers the stated purposes of SEP, the loans supported by the third-party loan insurance must be for the purchase and installation of energy efficiency and renewable energy measures consistent with the SEP regulations.

Obligation, Drawing Down and Expenditure of Funds

Revolving loan funds

Obligation

Program monies advanced for a RLF are considered obligated by the grantee once they have been used to capitalize a RLF. A RLF may be capitalized in any of the following circumstances:

a) Receipt of a loan application from potential borrowers
b) State or local requirements (regulatory, statutory, or constitutional) dictate that funds be available in advance
c) The distribution account is operated by a third party; or
d) If a grantee establishes and operates RLF, funds would be considered obligated by the grantee upon submitting a letter to the Project Officer and receiving a confirmation response from the Project Officer. The letter must: (1) provide the strategy for the RLF and (2) identify the scope and size of the loan program.

Draw Down

Funds may be drawn down from the Department of the Treasury's Automated Standard Application for Payments (ASAP) system to fund the revolving loan fund at the time the fund is obligated. ASAP is the system by which grantees receiving financial assistance from DOE can draw down the funds that have been pre-authorized by the agency for payment. If a grantee required draw down under requirements "b" or "c" listed above, the grantee should document the relevant requirement and provide that documentation to their Project Officer.

Expenditure

Self-administered:

Funds are considered expended (outlaid) when the RLF has loaned to specific borrowers for an amount equal to or greater than the SEP funds that initially capitalized the fund. The value of loans issued in any reporting quarter is to be reported as expenditures (outlays) for that quarter.

Third party-administered:
For revolving loan funds administered by a third party, grantee funds are considered expended (outlaid) when the funds have been transferred to the third party for operation of the RLF. Funds transferred to a third-party administrator in any reporting quarter are to be reported as expenditures (outlays) for that quarter.

If an RLF is administered by the grantee, all funds *must*:

- Be loaned out (initial round of funding) within the timeframe specified in the terms and conditions of the award agreement;
- Be converted for use to an approved program activity after submitting and finalizing an amendment through DOE Project Officer and Contracting Officer; or
- Be returned to the Federal government.

If an RLF is administered by a third party (subgrantee or vendor), all funds *should*:

- Be loaned to specific borrowers (initial round of funding) by the end of the project period specified in the terms and conditions of the award agreement;
- Be converted for use of approved program activities after submitting and finalizing an amendment through a DOE Project Officer and Contracting Officer; or
- Be returned to the Federal government.

Regardless of whether an RLF is administered by a grantee or a subgrantee, if the RLF does not loan out funds for eligible activities under the program then DOE may take an enforcement action against the grantee and/or subgrantee, subject to the flow down provisions of the subagreement, for noncompliance of the terms of the award agreement and disallow all or part of the cost of the activity or action not in compliance or other allowable remedies against the grantee and/or subgrantee, subject to the flow down provisions of the subagreement. *See* 10 CFR 600.243

Loan loss reserves:
Obligation:
LLR funds are considered obligated when they are committed as a credit enhancement to support a loan or portfolio of qualifying loans under the SEP guidelines.

For LLRs supporting a new or existing Recovery Act or non-Recovery Act funded financing program operated by the grantee, LLR funds are considered obligated by sending a letter to the Project Officer indicating the establishment of the LLR.

For LLRs supporting third-party loans, LLR funds are considered obligated when the grantee enters into a signed agreement with the third party.

Draw Down

Once LLR funds have been obligated, the funds may be drawn down from the Department of the Treasury's Automated Standard Application for Payments (ASAP) system to fund the LLR account.
ASAP is the system by which grantees receiving financial assistance from DOE can draw down the funds that have been pre-authorized by the agency for payment.

Expenditure
Self-administered:
LLR funds are considered expended after they have met the above requirements for obligation, the grantee has drawn funds down from the ASAP system to fund the LLR account and committed them to support (a) individual loans; or (b) a portfolio of loans that a third-party commits to issue. The value of funds committed to support loans in any reporting quarter is to be reported as expenditures (outlays) for that quarter.

Third party-administered:
For LLR funds operated by a third party, the grantee's funds are considered expended when the funds have been transferred to the third party for operation of the fund. The value of funds transferred to the third party for operation of the LLR in any reporting quarter is to be reported as expenditures (outlays) for that quarter.

Interest rate buy-downs and third-party loan insurance:
Obligation
Funds used for an interest rate buy-down or third-party loan insurance are considered obligated by the grantee once the funds have been committed to an interest rate buy-down or third-party loan insurance, in support of a loan or loan program. These funds may be committed in any of the following ways:

a) Receipt of a loan application from potential borrowers;
b) Where state or local requirements (regulatory, statutory or constitutional) dictate that funds be available in advance;
c) When the grantee enters into a signed agreement with a third party to support an ongoing loan program with interest rate buy-downs or third-party loan insurance; or
d) The grantee has entered into an agreement with a third party to operate the distribution account.

Draw Down
Funds may be drawn down at the time they are committed to an interest rate buy-down program or third-party loan insurance. If a grantee requires a draw down under requirements "b" or "c" listed above, they should document the relevant requirement and provide that documentation to their Project Officer.

Expenditure
Interest rate buy-downs and third party loan insurance are considered expended after they have met the above requirements for obligation and the grantee has drawn funds down from the ASAP system to fund the buy-down or loan insurance account.

Additional information regarding the character of interest rate buy-downs can be found in SEP program notice 12-002,"Guidance for State Energy Program Grantees on Interest Rate Buy Down Programs" issued June 4, 2012.1 This guidance (10-008D) does not supersede that guidance, and incorporates it as a reference.

Loan Defaults
Grantees are not required by DOE to replenish or replace any amounts which were lost to loan default. Loans involve risk by their very nature, so loss due to default of a borrower is an anticipated and allowable cost under an SEP grant. Grantees should utilize prudent lending practices to minimize the risk of defaults.

"Close Out" of Financing Programs
Grantees may end or reduce funding for a RLF program, LLR program, or other eligible financing program at any time as long as any remaining funds are used by the grantee for an eligible purpose after submitting and finalizing an amendment through the DOE Project Officer. If the funds are not used for an eligible purpose, the funds must be returned to the Federal government.

Interest Income from Advances
Any interest earned on funds which have been drawn down but not expended (outlaid) by a State grantee is subject to the terms and conditions of its grant. *See* 31 CFR 205.15 and 205.25; 10 CFR 600.225(g). This interest earned may be rolled back into the RLF or LLR account or used for another approved, eligible activity. If such interest is not rolled back into the RLF or LLR, or used for another approved eligible activity, it must be returned to the Federal government.

Program Income
All program income (including interest earned) paid to grantees is subject to the terms and conditions of the grant. See 10 CFR 600.225 (g)

Administrative expenses
Administrative expenses must be reasonable relative to industry standards and an estimate must be provided to the DOE Project Officer in advance for any financing program. Interest earned on loan funds and loan repayments are considered program income under 10 CFR 600.225(a) and can be used to pay administrative costs with those loan funds.

Continuing Federal Character of Certain Financing Programs
Funds used to capitalize an RLF or LLR retain their Federal character for the entire period of time that the funds are used for such purpose (i.e., at each revolution of funds).

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[1] http://www1.eere.energy.gov/wip/pdfs/eecbg_06-04-12.pdf

The Federal character is maintained even after the funds have been considered expended as described above.
As a result, federal requirements that apply to the funds such as program eligibility requirements, NEPA, and the National Historic Preservation Act (NHPA) would be applicable at each revolution of the RLF or when a grantee approves a third-party lender's request for coverage with loan loss reserve funds. Federal requirements that apply to Recovery Act funds, such as the Davis-Bacon Act (DBA) requirements, Buy-American provision requirements, and Recovery Act reporting requirements would be applicable at each revolution of a RLF or on any residual funds from LLRs that were funded through the Recovery Act.

The grantees who administer financing programs can expedite compliance with these statutory requirements as detailed below.

National Environmental Policy Act

Interest-Rate Buy Downs and Third-Party Loan Insurance

Prior to the grantee approving the expenditure of federal funds to a third-party lender, where the funds would support an interest-rate buy down (IRB) or a loan insurance policy, DOE must conduct NEPA review for the project or group of projects that will benefit from the funds. In many cases this will be impractical because the grantee (and possibly third party administrators) may not be able to identify proposed projects until well after the grantee establishes the financing program. As such, the easiest and most practical way for DOE to comply with NEPA review is to make a categorical exclusion (CX) determination for the entire financing program by using the SEP NEPA Template. IRBs and Third-Party Loan Insurance may qualify for a CX to the NEPA provisions, provided that the underlying projects to be funded under the financing program fall under the SEP NEPA Template. Grantees should consult with their Project Officer for further information.

Revolving Loan Funds

If the grantee uses the SEP NEPA Template that DOE has provided to grantees to obtain CX determinations under NEPA, then DOE can complete a NEPA review for entire RLF program without having to later conduct a NEPA review of individual projects.

Loan Loss Reserves

Recovery Act-funded LLRs can occur in three phases:

1) DOE expends Recovery Act funds that are used to establish and capitalize a grantee's LLR account;
2) a grantee approves an application from a third-party lender requesting coverage from a LLR to support a loan or a portfolio of qualifying loans (in this case, commitment of a LLR); and
3) a grantee draws funds from the LLR account to pay third parties for the financing of privately-funded projects, in the event of a loan default.

DOE does not need to complete a NEPA review in advance of phase (1) above. However, DOE must complete a NEPA review for this LLR activity prior to phase (2) above, at the latest. To that end, DOE must complete a NEPA review before SEP grantees commit funds to cover a third party's loans. While the requirements of DBA and the Buy American provision do not apply during phase (1), such requirements apply prior to phase (2) above.

For instances in which grantees intend to use SEP funding for LLRs supporting underlying projects that do not qualify for a CX determination (e.g., large, commercial-scale geothermal or wind projects), DOE will typically have to complete a NEPA review for the individual proposed projects. At the time that a third-party lender applies to the grantee for coverage from a LLR, the grantee must identify the project(s) that will receive the loan. DOE will then commence a NEPA review of such project(s), which will most likely result in an Environmental Assessment or Environmental Impact Statement. A grantee cannot approve third-party loans for coverage under the LLR program until DOE completes a NEPA review for particular projects that benefit from the LLR. Should the project proponent move forward with activities that are not authorized for Federal funding by the DOE Contracting Officer in advance of the final NEPA determination, you are doing so at risk of not receiving Federal funding and such costs may not be recognized as allowable cost share.

Even in those instances in which DOE must complete a NEPA review for individual projects that do not qualify for a CX determination, DOE may be able to expedite the NEPA review process by using a single NEPA document for multiple, similar projects. Also, if the total amount of Federal financial assistance (including federal funding reserved for the loss on the loan) for a project is less than 10 percent of project costs then the grantee should consult with DOE about whether DOE will have to prepare a NEPA determination for the project.

For grantees that anticipate seeking approval for LLRs that support projects which cannot obtain a CX determination, DOE encourages such grantees to submit a complete project description simultaneously with the third-party lender application for a credit enhancement. Otherwise, DOE may condition its approval of the LLR on a NEPA review and that conditional approval may serve as an insufficient guarantee to the lender.

Categorical Exclusions

Grantees should consider restricting their financing programs to activities categorically excluded from NEPA review (*e.g.*, including this restriction in any third-party LLR contracts).

For further information about the SEP NEPA Template, please review guidance that DOE has previously issued on streamlining compliance with NEPA.

That guidance and the SEP NEPA Template itself can be found at http://www1.eere.energy.gov/wip/pdfs/nepa_program_guidance_notice_10-003.pdf and http://www1.eere.energy.gov/wip/pdfs/template_nepa_review.pdf, respectively. Further, assuming that DOE exercises no control over projects that receive loans from a RLF, DOE *may* not have to prepare a NEPA determination for a project if the total amount of Federal funding for the project is less than 10 percent of project costs.

Historic Preservation, DBA, and Buy American

DOE has worked with the Advisory Council on Historic Preservation to provide States with programmatic agreements in order to streamline compliance with the NHPA requirements. Information on the programmatic agreements can be found at http://www1.eere.energy.gov/wip/historic_preservation.html.

Individual homeowners receiving loans under a RLF program or supported by Recovery Act-funded credit enhancements (e.g. LLRs, interest rate buy downs (IRBs), third-party loan insurance) would not be required to comply with the DBA. DBA is applicable to any loans to corporate entities. Grantees may wish to consider restricting their financing programs to activities for which compliance is not required under DBA.

Neither LLRs nor third-party loan insurance are subject to the DBA, because the funds are not being loaned/used for construction/installation work. Provided that the LLR fund is used only for the purposes of providing a fund for the third-party lender in the event of default by the borrower, the DBA is not applicable to the LLR fund.

Also, provided that the third-party loan insurance is used only for the purpose of providing funding to a lender or investor for the purchase of an insurance policy from a third party against losses on a portfolio of loans up to a fixed percentage (to stop loss) of the sum of all the original loan amounts, the DBA is not applicable to the third-party loan insurance.

LLR funds are used to protect the third-party lender in the event of default. The third-party lender obtains reimbursement from a LLR fund only in the event of a default by the borrower, and only after legal efforts have been exhausted to obtain additional repayment from the borrower. LLR funds are not used for the construction alteration, maintenance or repair of a public building or public work. Therefore, the DBA and Buy American provisions of the Recovery Act do not apply to LLR funds.

DBA is applicable to IRBs except when an the IRB supports a loan under which (1) an individual is hiring a contractor to work on their personal home/building; and (2) under

which a State or Local Government employee performs the work on a state or local government building.

The Buy American provision requirements apply to "public buildings" and "public works" and thus would not be applicable to projects performed on homes owned by individuals.

Continuing oversight of Federal funds

As noted above, generally, federal funds used to capitalize a RLF or fund LLRs continue to maintain their federal character in perpetuity. For such programs, the Federal character continues after expenditure and after the initial period of award. As a result, federal requirements that apply to the funds such as the NEPA, NHPA, DBA, Buy American provisions, and Recovery Act reporting requirements would be applicable at each revolution of the RLF or when a grantee approves a third-party lender's request for coverage with LLR funds. To ensure that grantees continue to use these Federal funds continue to be used in accordance with the applicable Federal requirements, DOE will maintain oversight of the funds remaining in financing programs past the period of performance stated in the grantee's award agreement. Grantees need to amend their State Energy Plans to include the market title for continued operation of financing mechanisms prior to the close of the Recovery Act award period.

A grantee may choose to end an RLF or LLR. A grantee may move funds out of an RLF or LLR as the funds are returned to the grantee (e.g., as loan payments are made). If the grantee ends such a program, the funds must be used for an eligible purpose or be returned to the Federal government.

Annual SEP funds may be used for administrative costs associated with the continued operation of the financing mechanism.

Grantee Reporting of Financial Programs

Following close of the Recovery Act award period, DOE will require reporting to confirm the funds are being used in accordance with their federal character. After the close of the Recovery Act award period, grantees with funds remaining in financing programs will be required to report information on the program until the funds are either: (1) rolled into another eligible activity and expended; or (2) fully expended through default; or (3) returned to the Federal government.

Pursuant to Section 210(c) of OMB Circular A-133, third-party lenders should generally be characterized as vendors providing financial services. As such, third-party lenders (*e.g.*, commercial banks) are not required to report any information directly to DOE. Prime grantees retain reporting authority and responsibility and therefore should not delegate any reporting responsibility to third-party lenders.

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