

## Potential capabilities for a Vermont green bank:

The Center for Public Enterprise, alongside submitting comments to the Vermont Treasurer's Office regarding the creation of a statewide green bank, has prepared a list of capabilities and functionalities that we believe a potential Vermont green bank must be able to exercise in order to meet the state's climate and community development goals. Below, we explain how each capability works and why including it will be important. We hope this list allows stakeholders to better understand everything that a green bank is capable of doing and why empowering one with these functionalities would serve public goals.

Below this list, we have outlined justifications for why we prefer that the Vermont Treasurer's Office endorse the creation of a public or quasi-public green bank—housed as or within a state financial institution—rather than a nonprofit green bank endowed with a state grant but otherwise institutionally separate. A green bank should be more than a financial institution; it should be an entity that can balance complex public goals and should be empowered to coordinate among state, nonprofit, and private actors to achieve those goals. To that end, it must be public or quasi-public.

## **The capabilities and functionalities of Vermont's proposed green bank should include but need not be limited to:**

- **Loan issuance.** The green bank should be able to issue loans to finance projects—as any bank would—particularly because many renewable energy projects rely on debt financing.
- **Concessional loans.** The green bank should be able to offer loans at lower interest rates, at longer maturities, and with more forgiving repayment schedules than private loan providers would. Given high private financing costs today, this capability is essential for ensuring that developers can still build otherwise-viable clean energy projects.
- **Bridge loan financing.** A project's construction period, during which it earns no revenue and could face delays, is the riskiest portion of a project for lenders to finance. For this reason,

construction bridge loans are more expensive than loans taken to finance a project's operation period. The green bank should be able to make construction bridge loans to project developers at better terms than private loan providers; the ability to do so would significantly buttress the cash flow of the borrower.

- **Loan underwriting.** The green bank should invest in building a staff of loan underwriters and internal risk management capacity to enable itself to assess borrower creditworthiness, ensuring that any loans do not place undue risk on the balance sheet of the green bank or put its solvency under threat. Supporting internal underwriting capacity allows for the bank to engage in deeper financial relationship-building with borrowers, lowering borrowing costs and collateral requirements over time for responsible and sustainable borrowers.
- **Credit enhancements.** The green bank should be able to provide credit enhancements to protect developers and municipalities, raising their creditworthiness and improving the terms on which they can raise financing from other sources. **Loan guarantees** for developers insure other lenders against those developers' default risks. Credit enhancement programs for municipalities, such as the [Texas Permanent School Fund](#), which uses bond guarantees to enhance ratings on school district bond issuances, ensure that municipalities can secure cheaper financing to invest in green projects. **Loan loss reserves** can fund **first-loss guarantees** as well to offset a pre-arranged level of developer losses. The green bank can extend these credit enhancements to municipalities, public developers, and private developers.
- **Equity investment.** The green bank should be able to make targeted equity investments into higher-risk, higher-reward projects, such as experimental technologies, that are socially and environmentally promising but are otherwise unable to secure equity finance at a reasonable expected cost from other sources. A green bank capable of providing equity support with a desired rate of return lower than private providers might require will attract promising green manufacturing and technology startups to Vermont. If so desired, the green bank could require that its equity investments in firms translate to active or passive governance rights in those firms. Deploying construction equity, in particular, allows the green bank both to control an investment and reap the benefits of the investment's potential appreciation in value—as [exemplified](#) by the Montgomery County Housing Production Fund's investments in social housing developments. In high interest rate environments, public equity can preserve vital project developments. The bank could also facilitate the ability of another state instrumentality

to undertake these investments.

- **Debt-to-equity swaps.** The green bank should be able to swap its debt investment in a project for equity of equal value if the green bank or other lenders have serious concerns about the project developer's creditworthiness. This swap would have the green bank forfeit the project developer's debt service payments but would give it active or passive governance rights in that developer commensurate with its equity share. Not only could the green bank execute this swap with a desired rate of return on equity lower than private market participants could, providing the project developer with necessary liquidity, but it could use its governance capabilities to steer the project back toward financial viability.

The green bank could also engage in **debt-to-grant swaps**, essentially forgiving its loans to developers in adverse circumstances or, alternatively, if developers meet or exceed certain project deliverables and impact criteria.

- **Buyouts.** The green bank should be able to finance a public developer's buyout of private developers' contracts to build and supply renewable energy resources to the grid in the event that those developers are reluctant to honor their contracts on account of expensive financing costs or supply chain snarls. A buyout by a public developer—which has a lower cost of debt, higher risk tolerance, and longer time horizon—allows it to build some projects that private developers may not be able to continue work on.
- **Co-financing.** The green bank should be able to co-finance projects alongside other public and private market participants, including but not limited to private banks, community development financial authorities, and pension funds. While co-financing would make the project developer's capital stack more complex, it allows the green bank and other lenders to limit their total exposure to the project developer's balance sheet.
- **Debt issuance.** The green bank should be able to raise debt on capital markets through bond issuances—as all other financial institutions do—to secure working capital for itself independent of state appropriations processes. A public or quasi-public green bank has the benefit of being able to raise debt at a far lower cost of capital than many private and nonprofit banks could, thanks to Vermont's high and stable state credit rating.

- **Revolving loan fund deployment.** The green bank should be able to deploy a revolving loan fund that can quickly and repeatedly finance capital expenditure over longer periods of time by recycling projects' revenue streams (including elective payments) into seed capital or bridge financing for new projects. A revolving fund set up on the balance sheet of the green bank or through an off-balance-sheet special purpose vehicle, capitalized through a state grant or bond issuance, would allow the green bank to operate independent of state appropriations processes.
- **Project preparation and contract structuring.** A green bank should be able to support developers in project preparation and contract structuring. All green projects will require both financial plans and impact assessments, neither of which a project developer is necessarily capable of doing itself at the speed and scale required. A green bank that assists developers here will not only be able to reduce its own overhead and due diligence costs when financing projects—likely by pushing standardization of contracts and assessment processes *and* by building internal due diligence capacity—but will ensure that project developers can also secure financing from other investors, which may be more likely to co-finance green projects if they know the green bank has helped structure them in a standardized manner.

Green banks should include **site identification and preparation services** and related pre-development activities in their offerings for developers as well. Identifying suitable land and preparing the regulatory assessments needed to develop projects on it *well in advance of developer interest*, something federal and state agencies have done for California's [Ten West Link](#) transmission line and Texas's [Competitive Renewable Energy Zone](#), is the kind of proactive strategy that would significantly ameliorate developers' regulatory and planning hurdles.

Green banks should include **tax credit and elective pay advisory services** as part of their project preparation capabilities to ensure that developers they work with are choosing the optimal mix of credits, federal and state subsidies, and other incentives—such as the federal Solar For All program—when planning projects.

Green banks should also include **project labor agreement and community benefit agreement advisory services** to ensure that developers it invests in are held accountable to public standards for a just transition and community development, including but not limited to fair wages for workers and support for vulnerable communities.

- **Securitization.** The green bank should be able to securitize its portfolio of assets to raise cheaper financing on the capital market. The green bank can likely do this through a process known as synthetic securitization, in which it tranches the default risk on a portfolio of its assets and purchases a loan guarantee on each tranche, effectively offloading its default risk and freeing up balance sheet space to issue new loans. This is a different process than true-sale securitization, in which the green bank would bundle and tranche its portfolio of assets and sell off the rights to those assets’ revenue streams, similar to a mortgage-backed security. While the green bank could do true-sale securitization, there may be political problems associated with essentially selling publicly financed assets, not to mention coordination problems in the event that these assets are co-financed alongside private partners. In either case, the green bank should be wary of periods of low market liquidity, during which it may overpay for guarantees or receive inadequate compensation for sales of asset-backed securities. A green bank empowered to invest, manage risk over a longer time horizon, and **warehouse** assets for future securitization mitigates these risks. A green bank aiming to securitize its portfolios would be best served by a federal counterparty such as a [National Investment Authority](#) providing a liquid source of financing for the green bank’s asset-backed securities or a **backstop** for guarantee purchases.
- **Tax credit monetization.** The green bank should be able to make tax equity investments in private project developers. Because many private tax-liable developers have tax liabilities too small to claim the full value of ITC or PTC tax credits they could earn on renewable energy investments, they sell their tax liability to a “tax equity investor,” usually a large bank, which gets equity in the developer in return for the ability to claim the full value of developers’ tax credits. Tax equity transactions allow developers to monetize the tax credits for their project upfront, but at a discount relative to the money they would have received if the Treasury had sent them funds directly. (A Credit Suisse report [estimates](#) that this discount can be as steep as 15 cents on the dollar.) A green bank that can engage in tax equity transactions at a lower discount than offered by competing private banks better supports private project developers, incentivizes them to work with the green bank more often, and pushes the discount lower over the longer term. All private project developers benefit from greater competition and liquidity in tax equity markets. That being said, the IRS has [not yet confirmed](#) that green banks can engage in tax equity transactions like this, a process referred to as “chaining.”
- **Central procurement.** Because supply chain pressures and input delivery delays present a real threat to timely project development—which in turn increases project financing costs—a green

bank should be able to act as a central procurer of key inputs that might be required across a wide range of capital investments. Through bulk orders of construction and electronics goods and services, a green bank can build buffer stocks for use during periods of market volatility or supply chain snags, keeping input costs stable for project developers across the state by providing a constant source of demand for input producers.

- **Grants.** The green bank should be able to issue grants to reward developers for certain actions. For example, the green bank can award grants to developers that meet or exceed project deliverables and impact criteria. The green bank can also issue grants to early-stage experimental technology developers, firms that are by nature higher-risk but promise significant societal benefits if they succeed at their task.
- **Partnerships with public universities.** The green bank should work closely with public universities to support renewable energy and green technology research labs, green finance education programs, planning spaces for just transition and community economic development policymaking, and workforce development and training programs. These four focus areas explicitly instrumentalize Vermont state universities' existing capacity for advancing cutting-edge research, local business development, local policymaking, and vocational education—and green bank support for these capacities can build a pipeline of interested students, researchers, professors, and workers whose scientific, business, policy, and technical expertise can be directed toward state climate investment goals.

**The proposed green bank should be a public or quasi-public entity—as opposed to a nonprofit entity unaffiliated with the state government—for the following reasons:**

- A public or quasi-public green bank can be given legislative mandates to ensure its investment strategies are accountable to Vermonters. A green bank held accountable to the needs of voters will be more prepared to advance economic development and a just green transition for vulnerable communities across the state. A public green bank with a public mission, accountable governance structure, and egalitarian investment strategy can avoid supporting investments that inequitably exclude vulnerable communities and displaced workers.
- A public green bank can coordinate among Vermont state institutions and with federal financing programs (*e.g.*, Solar For All) to meet economic development goals and target financial support toward vulnerable communities. Through this central coordination, a public

green bank can more easily integrate and balance climate, development, equity, and justice goals by aligning the missions of its partners. A nonprofit housed outside the Vermont state government apparatus may have a harder time executing this balancing act, since it would be less accountable to the state, less able to coordinate the expertise required to meet these goals, and potentially seen as less legitimate than a state actor.

- A public green bank builds state administrative capacity to plan and execute the kinds of complex legal and financial activities needed to prepare clean energy projects, mobilize investment toward them, and provide support to vulnerable communities. To that end, a public green bank can work alongside nonprofits and philanthropies. Outsourcing these capacities to a non-state entity means losing the ability not just to directly and transparently monitor the green bank's planning, execution, and partnership processes, but to ensure that other state instrumentalities can learn from them.
- A public green bank can take on more risk and think longer-term than its private and nonprofit counterparts could, especially if legislative support provides it with a mandate to do so. A public green bank can also make use of the creditworthiness of the Vermont state government when issuing bonds and providing credit enhancements. Additionally, a public bank helps raise public finance for green investment in a centrally coordinated manner.
- All green banks that seek to finance projects alongside private investor partners run the risk of subsidizing those investors and other financial intermediaries, enabling rent-seeking. A public bank that remains politically accountable and that is designed with guardrails to prevent rent-seeking can mitigate this possibility—but a nonprofit with a more opaque governance structure may not be able to.

CPE would be supportive of building a green bank either out of an existing Vermont state financial institution or as its own autonomous state entity; our comments on financial tools are applicable to either option.

### **About the Center for Public Enterprise:**

The **Center for Public Enterprise** is a non-profit think tank that specializes in building public sector capacity to deliver inclusive economic development. CPE works with government agencies and research and advocacy organizations on public-sector financing strategies primarily in the energy and housing sectors.



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