

# Northern California Community Loan Fund



**RCDI Workshop**  
**“Financing Woody Biomass Energy Projects”**  
**May 16, 2017**



# Agenda

- **NCCLF Overview**
- **Wood Innovations Grant: Financing Technical Assistance**
- **Sources of Capital: Grants, Equity, Tax Credits, Debt**
- **Investor IRR Model, Finding Investors**
- **Financial Structuring of Biomass Projects**
- **Underwriting Loans for Woody Biomass Projects**
- **Input and Feedback from Biomass Project Managers**
- **Q & A**

# Presenters



## David Wilkinson

### Senior Real Estate Consultant

A 30-year community development finance veteran, David has broad experience structuring high impact community facility projects utilizing New Markets Tax Credits and other creative sources of capital.



## Dan McDonald

### Deputy Director of Lending

Dan has over 33 years of experience in real estate finance, including debt and equity underwriting, workouts and dispositions, asset management and project management.



# Our Mission

## Investing in Opportunity, Together

NCCLF promotes economic justice and alleviates poverty by increasing the financial resilience and sustainability of community-based nonprofits and enterprises. Through flexible financial products and sound advice, we create opportunities to make socially responsible investments that revitalize Northern California communities.



# Our Programs

Lending  
&  
NMTC

Consulting

Socially  
Responsible  
Investing

Policy



# Wood Innovations Grant

- NCCLF awarded grant in 2016 (with encouragement and application assistance from the Sierra Nevada Conservancy and the Watershed Research and Training Center).
- Grew out of SWET-funded white paper, “Applying NMTCs and DPOs to Woody Biomass Projects in CA.”
- Purpose of grant: Assist Biomass Projects with Creative Financing Strategies to Capitalize their Projects.



# **Project Site Meetings in 2016**

- **Northfork CDC & Phoenix Energy -- Madera County**
- **Sierra Resource Conservation District -- Fresno County (Auberry)**
- **Sierra Institute -- Plumas County**
- **Mariposa Biomass & Cortus Energy**
- **Calaveras Healthy Impact Product Solutions (CHIPS) -- Calaveras County**
- **Camptonville Community Partnership & Gaelectric -- Yuba County**
- **Hat Creek Construction & West Biofuels -- Shasta Co.**
- **The Watershed Research and Training Center -- Trinity County**



# Financial Structuring

## ➤ Sources and Uses of Development Funds

### Uses:

- All costs and expenses to build a renewable energy project

### Sources:

- Grants
- Developer Contribution, Business Partners
- Investor Equity (tax credits, banks, private investors)
- Debt (Loans from banks, CDFI lenders)





# Keys to Financing a Project

- **Site Control:** Options to purchase, long-term leases; cleanup issues—Creative Center for Land Recycling can assist.
- **Preliminary Engineering (civil, project):** Site development, infrastructure, site plan, equipment, cost estimates.
- **Entitlements:** Zoning, environmental, permits.



# Keys to Financing a Project

- **Project Pro forma:** Income and operating expense projections; long-term source for biomass feedstock?
- **Maximizing Equity to Minimize Debt:** Increasing cash flow to be attractive to investors; lower BioMat price needed
- **Structuring Financing:** To achieve BioMat strike price.
- **Obtaining PPA through BioMat:** Revenue source is critical for project underwriting and loan.



# Recent / Prospective Grant Awards

- **CEC EPIC Grants:** Congrats to four awardees!
- **Economic Development Administration (EDA):** NOFA released for \$17m “i6 Challenge” grants
- **Community Development Block Grants (CDBG-EDBG):** County sponsorship, based upon job creation (Housing Elements in compliance?)
- **Rural Energy for America (USDA):** Too small
- **NCCLF Community Catalyst Loans:** Working capital during predevelopment phase



# Sources of Equity

- **Project Sponsors:** Land, Grants, Pre-Development Studies
- **Business Partners:** Technology and Equipment Companies provide cash, technical services, equipment in return for ownership % of project; LLC ownership structure created with help from experienced real estate attorney
- **Third-Party Investor Capital:** Cash for project tax benefits and cash flow
  - How to structure such a deal?

# Tax Credit Equity

- **Federal Investment Tax Credit (ITC)** for biomass, solar, wind, other renewable energy projects (purchased by large banks for the tax write-off); 30% of eligible project costs
- **Production Tax Credit (PTC)** for renewables, based on energy production.
  - Credits for woody biomass energy expired 12/31/16; now considered “orphaned technologies”, i.e., left out of the recently passed Omnibus Budget bill. Some support in Congress to renew, but Trump Administration showing little interest.
  - Tax Reform, being discussed in Congress, could reduce yield on all tax credits if lower corporate tax rate approved.



# New Markets Tax Credits

- Program extended through 2020 @ \$3.5b/year.
- Program's fate unclear if tax reform legislation becomes law; get them while you can!
- A **federal tax credit program** designed to stimulate investment in **low-income communities** or to assist low-income “targeted populations” through job creation.
- Investor receives a 39% tax credit spread over 7 years; they do not seek income from project.



# How Do NMTCs Work?

- Community Development Entities (CDEs) apply each year to U.S. Treasury for an allocation.
  - Very competitive process.
  - Application for 2018 allocation due June 21, 2017.
- If awarded, CDEs sell credits to investors. Proceeds contributed to facilitate investments (typically structured as low interest and forgivable loans) in qualifying projects.
- CDEs generally select projects located in highly distressed low -income areas, which result in high community impacts.



# How Do NMTCs Work?

- CDEs generally select projects located in highly distressed low -income areas, which result in high community impacts.
- Biomass projects are eligible for NMTCs, based upon job creation, geographical location, and other community and environmental benefits.
- Projects may have to be designed to benefit “targeted populations”.





# Utilizing NMTC Financing

- Key is to find CDEs with available credit allocations that are interested in woody biomass, wood-utilizing businesses, forest restoration and other environmental and economic development impacts.
- NCCLF is a CDE. Through the Wood Innovation Grant we are generating interest from other CDEs and bank investors.
- Projects must quantify impacts:
  - Jobs with Livable Wages: 10-15 jobs?
  - Renewable Energy as per State goals
  - Ancillary businesses utilizing energy and heat
  - Forest Restoration; Watershed Benefits, Fire Avoidance



# Net Benefit for \$10m Project\*

Sources & Uses	CDE Level	Project Level at Closing	Interest over 7 yrs to pay CDE expenses
NMTC Equity from Investor Bank (\$10M x 39% x \$.85 purchase price)	\$3,300,000	\$3,000,000	\$2,630,000
- CDE Fee (3% of \$10m QEI)	(\$300,000)		
- Legal, Accounting, Consulting Fees		(\$370,000)	
- Annual Asset Mgmt. & Monitoring Fees (Spread over 7 years -- 3.5% of QEI)			(\$350,000)
<b>Net Project Benefit (22% of \$10M Budget)</b>	<b>\$3,000,000</b>	<b>\$2,630,000</b>	<b>\$2,280,000</b>

**\*For illustration only: Actual fees will vary!**



# Attracting an Investor

- Biomass project must be structured to provide financial incentives to the investor that provides capital (cash), credit support (guaranties), or both.
- Without ITCs, investors are looking for stable cash flow and tax shelter (accelerated depreciation) benefits.
- Investors want 12-15% return on investment (IRR); may stay in the deal for the long term.
- NCCLF is assisting projects with Investor IRR models using Novogradac CPA.



# Example: Financial Structuring

- **Sources and Uses of Development Funds**
  - **Uses:** \$25m cost for 3 MW bio-energy project (includes all financing costs)
  - **Sources:**
    - \$4.9m investor equity (**49% ownership**)
    - \$5.0m sponsor equity-EPIC Grant, Land (**51% ownership**)
    - \$15.0m Loan (Debt)



# Example: Financial Structuring

## Operating Income:

– Price per Kwh:	\$ .175
– Energy Sales:	\$3.8 m per annum
– Other:	\$0.6 m
(heat or biochar sales, lease revenue)	
Gross Income:	\$4.4 m
Operating Expenses:	\$2.8m
Loan Payment:	<u>\$1.1m</u> (20 yrs, 5.5%)
<b>Before Tax Cash Flow:</b>	<b>\$ .5m</b>

**Investor (49%) Rate of Return: 19% (20 yrs)\***

**\* includes 49% cash flow and 100% tax losses (depreciation)**



# Deal Structuring

- Get good legal advice with experienced real estate attorney (NCCLF can help identify one).
- Majority Control vs. Cash brought to the table
- Nonprofit sponsor may have to be a minority partner to attract sufficient equity to the project; getting a fair deal.
- Where are the Investors? NCCLF exploring with Novogradac and speaking with investors, with IRR project schedules in hand.

# Loan Products

## Real Estate Loans

- Pre-development
- Acquisition
- Refinance
- Construction
- Perm

## Working Capital Loans

- Business expansion
- Inventory purchase
- Equipment

## Lines of Credit

- Cash flow management tool to bridge accounts receivable
- Short-term financing

- **Up to \$3 million (more through participations with other lenders)**
- **Term: Up to 10 years**
- **Amortization: Up to 25 years**
- **Lines of Credit: 12 months (renewable)**
- **Rate: Negotiable but generally between 5.5% - 6.5%, fixed**
- **Real estate secured or UCC-1 filing on assets**



# Underwriting

## What does that mean in general?

- **Process of investigating:**
  - Facts
  - History
  - Physical conditions
  - Applicable laws and regulations
  - Financial condition of parties of interest
  - Other issues that could affect lender's decision to provide financing



# Underwriting

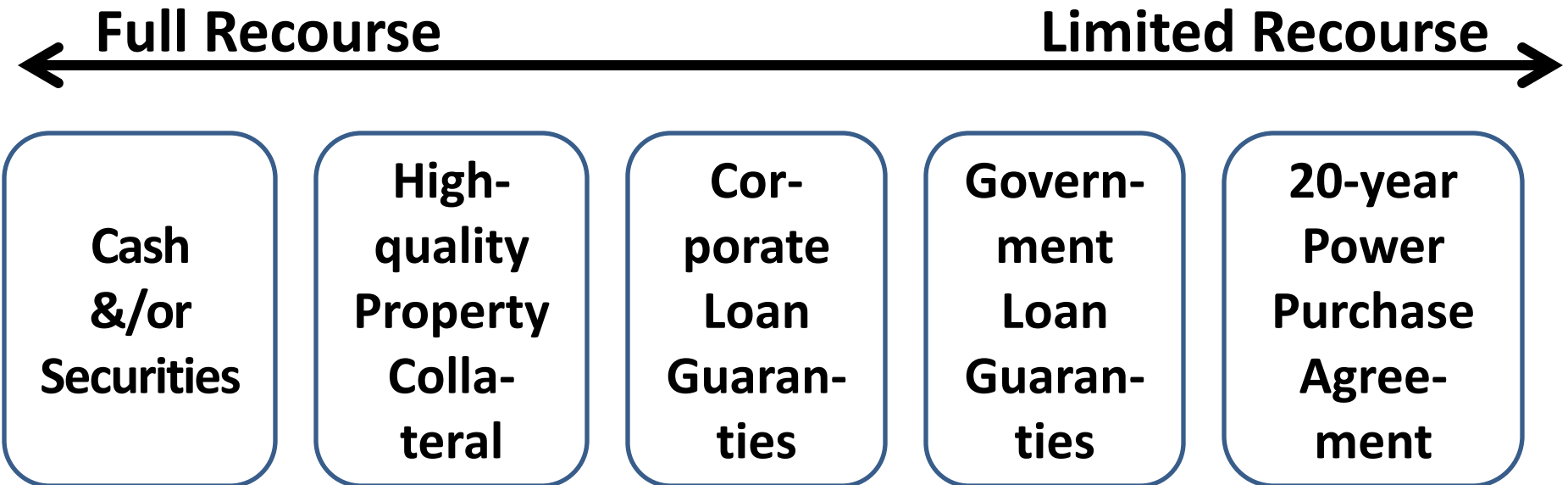
## What does that mean for a biomass loan?

- **Determining and documenting Borrower's ability and willingness to repay the loan:**
  - Financing structure
  - Lien position
  - Borrower
  - Collateral
  - Credit support &/or credit enhancement
  - Documentation

# Underwriting Risk Mitigation Continuum

## Risk vs. Return Trade-off for Lender

Lenders will forgo a higher yield for a lower risk



**Non-recourse is impossible to achieve!**



# Underwriting the Risk Continuum

**Most lenders do not provide all three types of loans**

## Type of Loan



**Early stage lending is the most risky.  
Needs the most “credit support” and/or  
“credit enhancement”**



# Underwriting Project Capacity

**Can the borrower repay the loan  
from project income?**

- **Project pro forma analysis:**
  - Operating assumptions (revenue, expenses, reserves, allowance for downtime/maintenance)
  - Cash flow projections (year-over-year % growth)
  - Debt service coverage ratio (“DSCR”). Ex. 1.25x
  - Take-out sources (if not fully amortizing loan)
- **Use stress tests and underwriting rates to gauge sensitivity to changes in assumptions.**

# Underwriting Borrower Character

**Borrower organization, history, and behavior reveal weaknesses/strengths?**

- **Prior Financial Performance**
  - Success or failure in other ventures
  - Loan defaults, foreclosures, bankruptcy
- **Organizational Strength**
  - Management experience
  - Banking relationships
  - Financial statement quality
  - Principals' personal/business reputation
- **Overall responsiveness throughout underwriting process.**



# Underwriting Project Capital

**Does the project have sufficient equity, of the right type, and access to reserves?**

- **Capital structure—many options, choose wisely**
- **Types of Equity Capital**
  - **Best is patient, seeking long-term results**
    - **Impact investors -- angels, angel groups, funds, family offices**
- **Debt-to-equity ratio – lower is preferable**
- **Liquid reserves—Need equity partner with ability to inject cash to cover deficits**

# Underwriting Project Collateral

**Can the borrower provide adequate collateral?**

**What is the value of biomass collateral?**

- **Loan to Value – Difficult to appraise a biomass project**
  - Few comparables
  - Appraisal expertise very hard to find
- **Preferred Collateral:** High quality (easy for lender to sell if needed) but difficult to identify in a biomass project.
- **Collateral value :** Market value of equipment (as new), raw materials vs. salvage value upon liquidation.

# Underwriting Market/Environmental/ Economic Conditions

- **Positive/negative trends that could affect Project:**
  - Local development restrictions
  - Community opposition
  - Construction costs
  - Fuel, wood costs
  - Price/demand for biochar
  - Revenue from biomass business park tenants
  - Outlook for products produced by biomass business park tenants
  - Availability of long-term supply contracts





# Let's Connect!

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