



**Department of Energy**  
Washington, DC 20585

**SEP PROGRAM NOTICE 10-08**  
**EFFECTIVE DATE (Revised): April 20, 2010**  
**ORIGINALLY ISSUED: March 8, 2010**

**SUBJECT: GUIDANCE FOR STATE ENERGY PROGRAM RECIPIENTS ON FINANCING PROGRAMS.**

**PURPOSE**

To provide guidance to Department of Energy's (DOE's) State Energy Program (SEP) Grantees on revolving loan funds and loan loss reserves.

**SCOPE**

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

**LEGAL AUTHORITY**

SEP is authorized under Energy Policy and Conservation Act, as amended (42 USC 6321 et seq.). All grant awards made under this program shall comply with applicable law, including the Recovery Act, and other procedures applicable to this program.

**GUIDANCE**

**Eligibility of revolving loan funds**

A revolving loan fund 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 under 10 CFR 420.18(d).

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

State arrangements for leveraging additional public and private sector funds, including rebates, grants, and other incentives, must be arranged to ensure that federal funds go to the "purchase and installation of energy efficiency and renewable energy measures." 42 USC 6322(d)(5)(A). 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.

**Loan Loss Reserves under the SEP**

SEP funds can be used for a loan loss reserve 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 SEP, the activities supported by the leveraged funds are limited to those activities for the purchase and installation of energy efficiency and renewable energy measures consistent with the SEP regulations. Additionally, a grantee must ensure that the following conditions are met:

- a) Grantee shall have the right to review and monitor the 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 ARRA funds (e.g., Davis Bacon, and Buy American) where applicable.
- b) A grantee establishing a loan loss reserve 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 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 according to the original restrictions of SEP.
- 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 ARRA SEP funds for a loan loss reserve.

**Interest Rate Buy-Downs**

SEP funds can 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 can 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.

### **Loan Guarantees**

As stated in 10 CFR §420.18, SEP loan documents may not include principles of loan forgiveness [§420.18(e)(2)], and may not be used for loan guarantees [§420.18(f)(2)].

### **Obligation & Drawing Down of Funds**

Loan Capital: Program monies being used for a loan fund are considered obligated by the recipient once they have been used to capitalize a loan fund. A loan fund 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
- c) The distribution account is operated by a third party

Funds may be drawn down at the time the fund is capitalized. If a recipient requires an earlier draw down under requirements “b” and “c” listed above, they should document the relevant requirement and provide that documentation to their Project Officer.

Funds are considered expended when the revolving loan fund has loaned to specific borrowers for an amount equal to or greater than the program monies that initially capitalized the fund.

Loan loss reserve funds are considered expended when they are committed as a credit enhancement to support a loan or portfolio of qualifying loans under the SEP guidelines. For loan loss reserves supporting a revolving loan fund operated under the grantee, loan loss reserve funds are considered committed by sending a letter to the project officer indicating the establishment of the loan loss reserve. For loan loss reserves supporting third party loans, loan loss reserve funds are considered committed when the grantee enters into a signed agreement with the third party.

### **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.

**Federal Character of Revolving Loan Funds**

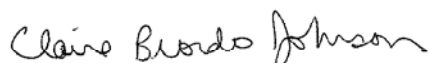
Generally, federal funds used to capitalize a revolving loan fund maintain their federal character in perpetuity. As a result, federal requirements that apply to the funds such as NEPA and the National Historic Preservation Act would be applicable at each revolution of the loan fund. Federal requirements that apply to Recovery Act funds, such as the Davis-Bacon Act requirements, Buy-American requirements, and Recovery Act reporting requirements would be applicable at each revolution of a loan fund that was funded through the Recovery Act.

The applicability of these federal requirements need not cause difficulty in administering a revolving loan fund program. DOE has previously provided guidance on streamlining compliance with NEPA and the National Historic Preservation Act. The templates that DOE has provided to States to obtain categorical exclusions under NEPA for sub-grant programs could also be applied to revolving loan funds program. DOE has worked with the Advisory Council on Historic Preservation to provide States with programmatic agreements in order to streamline compliance with the National Historic Preservation Act requirements. Individual homeowners receiving loans under a revolving loan fund program would not be required to comply with the Davis-Bacon Act. Similarly, the Buy American requirements apply to “public buildings” and “public works” and thus would not be applicable to projects performed on individual homes.

The continuing federal character of the funds means that if the grantee decides to end a revolving loan fund program or loan loss reserve program, any remaining funds would need to be used by the grantee for an eligible purpose or otherwise returned to DOE.

**Program Income**

All program income (including interest earned) paid to grantees is subject to the terms and conditions of the original grant.



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