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In a 'Watershed' Deal, Securitization Comes to Commercial Efficiency

Connecticut's green bank executes the first securitization of commercial efficiency assets.

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Securitization, the holy grail of energy efficiency finance, has finally arrived in the commercial sector.

Connecticut's green bank, the Clean Energy and Finance Authority (CEFIA), today announced a deal to bundle and sell a sizable chunk of its C-PACE loan portfolio to the specialty finance company Clean Fund. The bonds, issued by the Public Finance Authority, are backed by $30 million of commercial PACE loans funding energy efficiency in commercial buildings in the state of Connecticut.

This transaction represents the first known securitization of commercial energy-efficiency loans, and it may be the event that finally unlocks institutional capital for efficiency finance. The deal comes a couple of months after the first securitization of $104 million in residential PACE loans in California.

Clean Fund has agreed to purchase $24 million of a $30 million bond issuance, with CEFIA holding on to the remaining $6 million of bonds as a first loss position. The commercial assets included in the securitization represent a diversified portfolio of property owners funded through a $40 million CEFIA warehouse program, including a major commercial office building in Middletown, a YMCA in Danbury, and a strip mall in Norwalk. The portfolio also features 750 kW of solar PV systems.

Ultimately, an estimated twenty to 30 properties will be included in the $30 million portfolio. The assets have an average life of 8.77 years, the senior bonds issued have a coupon of 5.1 percent, and Clean Fund's price net of discount equates to 96 percent of par. The selldown will take place in three separate events in tranches of approximately $10 million apiece between now and the end of 2015.

CEFIA will use the proceeds to replenish its warehouse facility and fund new C-PACE transactions in the Connecticut commercial buildings market. The first tranche of projects is fully funded and includes cash flows from eleven different projects.

“This is a watershed moment, because, by doing this deal, it proves that energy efficiency is able to attract private capital, and private capital is going to be the force that gets energy efficiency to the tipping point," said John Kinney, CEO of Clean Fund.

Clean Fund is a PACE investor across the country. It has closed deals in multiple states and hopes to support $1 billion in PACE projects, both as a direct lender and through the purchase of existing assets.

Kinney was also quick to recognize the significance of CEFIA’s role in demonstrating proof of the commercial PACE warehouse model concept.

“There won’t be many governments that are willing to do what Connecticut has done," said Kinney. "CEFIA has been instrumental in proving that this can work and catalyzing the PACE market by just demonstrating that, when capital is available and an origination team is working with responsible vendors, a lot of transactions happen.”

Creating the first securitized commercial efficiency portfolio took a long time. Bert Hunter, CEFIA’s Chief Investment Officer, said figuring out how to compensate multiple parties in the event of a loss was tricky.

"We spent a fair amount of time trying to get that right to everyone’s individual comfort. It just took a while to think through and then document. And second, because of the structure, we had to make sure that the payments against the projects in the first tranche were completely dispersed. And we wanted to have our first sale of bonds to be in a number sufficient to justify the issuance. We didn’t really hit that mark until the end of April," he explained.

One element missing from this deal is a rating of the bonds by an independent agency, as is customary in most large securitization deals. According to Hunter, a rating for this deal simply wasn’t feasible.

“Due to the portfolio’s size, a rating would have been prohibitively expensive. Also weighing against a rating is the limited number of transactions that were fully funded in the first tranche. Rating agencies require dozens of fully funded transactions with some performance history to assess the likelihood of default and to do stress-test analysis," he said.

However, CEFIA recognizes the importance of ratings in deals like this, and it plans to work more closely with rating agencies. “Once the portfolio is fully funded, a rating may be considered,” said Hunter. “But it is more likely that this would happen once this portfolio is combined with a future and larger issuance in order to achieve the scale and diversity that the rating agencies consider.”

Connecticut has been at the forefront of developing a viable energy efficiency investment platform in commercial buildings. Today’s sale may help the efficiency industry tap into the trillions of dollars that could be deployed for efficiency projects. Now that the securitization concept is proven, it’s only a matter of time before big money throws its weight behind energy efficiency.