CLEAN ENERGY FINANCE GUIDE, THIRD EDITION

DECEMBER 9, 2010

Chapter 3.

Risk Assessment

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This chapter is designed to help grantees assess the potential risks of lending products and the clean energy financing programs based on them. It highlights a set of issues that grantees should carefully consider, with the goal of helping them assess and anticipate solutions for some worst case or unfortunate case scenarios as they develop lending programs.

In the design phase, grantees and their partners will find it helpful to consider what could go wrong with a program as it rolls out and gets implemented. They can strategize as to which actions at the front end of the program they could take to address or mitigate each issue. The table below presents a set of program risks, defines them, and offers a brief perspective on potential ways to resolve the risks.

General Risk Category	Definition	Potential Resolution
Legal Issues/ Failure to Comply with Program Rules		
	Fraud: Lender partners abuse the loan loss reserve fund, drawing on the reserve for loans that have not met the strict definition of default, per the loss reserve agreement.	– Make sure that the loan loss reserve agreement is well constructed, based on sample documents provided elsewhere in this Guide. – Work closely with lenders to be certain that they understand the program requirements at the outset.
	Installation of nonqualified measures: Contractors use funds to install nonenergy efficiency or nonrenewable energy measures. Examples might be the use of funds to install a swimming pool or a residential room addition.	– Be sure that the contractors receive a clear explanation of the program guidelines. – Review contractors' business practices and financial health prior to qualifying them to participate in the program. – Conduct periodic inspections of contractors' work.
	Litigation: Poor installations, injury, or other problems result in a lawsuit against a grantee.	– Review contractors' business practices and financial health prior to qualifying them to participate in the program. – Conduct periodic inspections of contractors' work.
Complaints from Borrowers and Consumers		
	Complaints against contractors: Contractors associated with the program perform substandard work that does not yield energy savings or simply does not work. Contractors carry out the work, but damage the property.	– Develop explicit contractor performance standards. – Set up and use contractor monitoring protocols. – Be sure that a process for receiving and addressing complaints about contractors is in place from the start.

General Risk Category	Definition	Potential Resolution
	Complaints against lenders: Lenders make new borrowers uncomfortable through "pushy" attempts to cross-sell other financial products to them.	– Establish an open process of communication with lenders to be able to address complaints, should they arise. – Review grantee-lender joint marketing materials. ***Note***: Many lenders will choose to participate in a clean energy lending program not because they see great potential for profitability from the clean energy loans, but because they hope to cross-sell other products such as home equity loans to customers.
Little or No Take-Up of Loans		
	No loans or very few loans are extended to homeowners or businesses: A grantee establishes a loan program, but no loans are made.	– Examine the most common barriers to program uptake, which include poor marketing, poor integration with contractor networks, high transaction costs (fees or paperwork) that deter customers from taking out loans, and high transaction costs that deter contractors from participating in the program.
Poor Lender/ Contractor Participation		
	Contractor refusal to participate: Contractors find the program too cumbersome because of large amounts of paperwork or higher costs than they would incur outside the program.	– Try to keep paperwork requirements to the necessary minimum so that contractors can fill out paperwork quickly. – Avoid high fees; but note that in some cases, contractors are accustomed to paying fees to the primary lender to participate in financing programs or to accept credit card payments from customers. Such fees may range from as low as 3% to above 20% of the transaction value (cost of the work).
	Lenders refuse to loan: A loan loss reserve fund is made available to lenders, but the lenders do not make any loans or make very few loans on the basis of that loss reserve. Lenders may sign up for a loan loss reserve program and not make loans, or they may simply decline to sign up for the reserve program.	– Try to pinpoint the lenders' hesitancy to participate in the program. Some reasons might be— - Concern that financial regulators may require them to set aside significant amounts of money as a reserve, if loans are deemed too risky. - Lack of capital to loan. - Concern over high transaction costs to originate loans with a small loan value. - Concern that the credit enhancement may not compensate for the risk that the lender perceives in the target market.

General Risk Category	Definition	Potential Resolution
Other		
	Excessive loan defaults: Loan defaults, while projected to be low, turn out to far exceed projections.	– Examine and potentially tighten underwriting standards. – Examine loan collection procedures and review whether lenders are given adequate motivation to conduct high-quality collection procedures.