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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

USDA Doors Still Open To Cleantech After DOE Loan Firestorm

By **Liz Hoffman**

Law360, New York (October 19, 2012, 6:53 PM ET) -- The U.S. Department of Agriculture made loan guarantees to three biomass energy projects this month, a quiet reminder that after the political firestorm sparked by the U.S. Department of Energy's renewable financing program, one federal lending window is still open to clean technologies.

The loan guarantees, totaling about $341 million, went to biomass projects in Texas, Colorado and Hawaii. All three will turn wood pellets into fuel, a technology that, while far from science fiction, has yet to make a major dent in the U.S. energy market.

They are among two dozen projects that received $1.95 billion this month from the USDA's Rural Utilities Service, the small, Depression-era agency cast in recent years as a funder of clean energy projects, especially those that use crops or sell power to rural cooperatives or public utilities.

The loans aren't big enough to draw the ire of House Republicans, who have seized on the failure of Solyndra LLC and other ill-fated recipients of government aid. But they are a key step in supporting infant technologies through the funding gap on the way to commercialization, said Mark J. Riedy, a clean energy partner at Mintz Levin Cohn Ferris Glovsky & Popeo PC.

"The USDA's history is much longer and much less controversial than the energy department's," Riedy told Law360. "The DOE blew up, but the USDA is still chugging along."

The loan guarantees provide a credit wrapper to turn non-investment-grade debt into loans the companies can take to the private market. Historically, the USDA offered backstops for up to 80 percent of the debt. Last year, the agency expanded its role, offering a 90-10 split.

"It's almost like waving a wand over non-investment-grade paper," Riedy said. "You're still going to have the uncovered portion of the debt, but the federal guarantee does wonders in getting a project to financial close."

Several unproven technologies have benefited from the USDA's support. A New Mexico demonstration-scale "green crude" facility, which will produce oil from algae, came online this summer after receiving a $54.5 million USDA loan guarantee last year. In August, the agency backed a $99 million loan for a Chemtex International Inc. plant that hopes to turn grass into ethanol. In January, it made a $232.5 million guarantee to ZeaChem Inc. to build the company’s first commercial-scale plant refinery.

Without a history to lean on, these projects can't find commercial debt, experts said. Most U.S. banks won't lend to a technology that hasn't been in commercial use in the U.S. for at least five years, said Haynes and Boone LLP's Gilbert Porter.

"It's a small program, but an ambitious one," Porter said. "They're dealing with new technologies that don't have a track record, and they are going where the financial community won't yet go."

USDA debt is both cheap and long-lived. The agency will fund a project at 12.5 basis points — 0.125 percentage points — over U.S. Treasury bonds, for either the length of its power purchase agreement or 35 years, whichever is shorter. Even with higher rates on the nonguaranteed portion of the debt, the program is a bargain.

But it asks a lot of the private banks that co-finance the projects, and it isn't for the financial community's faint of heart, attorneys said. The customer on many USDA loans is actually not the borrower, but the lender for the uncovered debt, who serves as a sort of contractual babysitter. It runs the data, oversees construction and reports back to Washington regularly, attorneys said.

"The lead banks effectively serve as USDA's first policing force," Porter said. "They aren't just filling out forms. They have significant at-risk responsibility."

As a result, the lending club for the nonguaranteed portion of USDA-financed projects is small, mostly limited to technology banks like Silicon Valley Bank and Square 1 Bank, Porter said. Deutsche Bank AG jumped onto the recent Hawaii project, but had a homeland connection to one of the project's equity partners, German engineering firm Standardkessel Baumgarte Contracting GmbH.

In exchange for taking on more risk, lenders will find an agency that is smaller and nimbler than its DOE counterpart and a little more flexible on terms and structure, lawyers say.

For example, Deutsche Bank will provide 20 percent of the Hawaii project's construction financing. After the plant is complete, it will sell the asset back to the USDA, which will continue to support it through the Federal Financing Bank, according to Haynes & Boone, which represented Deutsche Bank.

Three USDA loan programs are open to clean energy or efficiency projects. The Rural Energy for America loan guarantee program has a debt ceiling of $25 million per borrowers and the Business and Industry guarantee program is capped at an even lower $10 million. The larger Biorefinery Assistance program covers up to $250 million in senior debt, though it requires that more than half of a project's capital costs to go toward producing advanced biofuels.

All have flown below the radar of the DOE's credit program, which directed some $35 billion to solar and wind generation, renewable technologies and manufacturers. Several recipients, like Solyndra LLC or Abound Solar Inc., have since filed for bankruptcy, putting the DOE in Congress' scopes and undercutting political support for President Barack Obama's green jobs push.

The USDA doesn't have an unblemished track record. Back in 2008, it made an $80 million construction loan guarantee — its first for a biofuels company — to Range Fuels Inc., a Georgia-based company hoping to turn wood into ethanol. The technology was was supposed to help the U.S. produce a billion gallons of ethanol by 2012. Energy Secretary Samuel Bodman, whose agency also kicked in a $76 million loan, attended the groundbreaking of the plant.

But Range defaulted on the loan. The plant closed down in 2011 without having produced a drop of usable fuel. AgSouth Farm Credit Bank foreclosed on the company and sold its assets in January.

But fears that Range would become the Solyndra of the biofuels world and the USDA's loan program seem to have been overblown, Haynes & Boone attorneys said. The program hit its $250 million smart grid lending goal for all of 2012 in August. Changes in the Farm Bill reauthorization, which the Senate is expected to vote on early next year, will likely relax some restrictions for biofuels companies seeking USDA aid.

And while the energy department's loan program was a key part of the 2009 stimulus, the USDA has its financing roots in the New Deal. It's not tied to recovery, but to a longer-term plan to develop America's biofuels industry.

"The DOE was a sprint. The USDA is more of a marathon," said Chris Wolfe, head of Haynes & Boone's cleantech practice. "It's a program focused on the long term, and it's enjoyed a little political protection because of that."

--Editing by Elizabeth Bowen and Katherine Rautenberg.