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USDA Biofuels Loan Guarantee Program Interim Final Rule Gives Program Added Boost

BY MARK J. RIEDY

On February 14, 2011, acting upon the significant input of Mintz Levin's Mark J. Riedy, Stern Brothers' John May, and Krieg DeVault's John Kirkwood, the U.S. Department of Agriculture (USDA) published its interim final rule for the 9003 Advanced Biofuel Guaranteed Loans program. The USDA's interim final rule ushered in a host of changes to address the larger issue of making this debt more attractive to investors. Although entirely operative, this interim final rule, however, is not the final rule and a formal comment period ended April 15, 2011 to achieve that end.

The new interim final rule incorporates, among other substantial changes, a unique new bond-financing mechanism created by Mintz Levin, Stern Brothers, and Krieg DeVault that should serve to enhance the program's ability to link investors with capital-constrained advanced biofuel and bioproduct refineries. Also, on March 11, 2011, the USDA issued the Section 9003 fiscal year 2011 Notice of Funds Availability (NOFA).

The 9003 Loan Guarantee Program

The 9003 loan note guarantee (LNG) program originally was authorized under the Biorefinery Assistance Program (Farm Act 2008, Title IX, Section 9003), which is currently funded through fiscal year 2011. The program targets new and emerging technologies for advanced biofuel—and more recently bioproduct—refining (biofuels and bioproducts that do not rely on corn kernel starch as the feedstock), and issues LNGs to the lender applicant (U.S. regulated commercial bank) covering the development, construction, and retrofitting of commercial-scale refineries. The program funds up to $250 million of senior debt per project, but until recently and still in most cases will not cover more than 80% of the project's total costs. However, under the new interim final rule, it will cover up to 90% of these costs, under certain conditions and subject to the program's per project funding ceiling. Despite a very precarious but intense budget situation in Washington, the program has survived based on its merits. A spate of continuing resolutions—temporary budgetary extensions passed in order to keep the federal government running—cut additional government programs in the weeks leading up to finalizing the FY2011 budget in April. But, the program retained its place in the constellation of federal renewable energy incentives for at least another year.

The interim final rule is in response to demonstrable problems with the earlier program structure which was established under the 2008 Farm Act through a series of NOFAs from 2008–2010 (the 2008–2010 NOFAs) and not by a formal rulemaking. With a final rule still ahead, on March 11, 2011, the USDA published in the Federal Register the FY2011 NOFA, providing a minimum of $463 million ($129 million allocated this year from the statutory amounts withheld under the Farm Act of 2008 from the FY2009–FY2010 LNG program, multiplied by an OMB multiplier of 3.589) plus any balance in roll-over funds from the earlier years' LNG program. The USDA expects to award four to five loan guarantees with the FY2011 NOFA.

Section 9003 largely was modeled on the USDA Business and Industry (B&I) financing program.

However, the network of USDA applicants (mostly small agricultural, U.S. regulated commercial banks) either could not or would not provide the amount of competitive commercial loans required on the comparatively large debt financing deals envisioned by Section 9003 under the 2008–2010 NOFAs and at the low interest rates and long tenors necessary for amortizing these renewable energy projects. The financial crisis caused the number of commercial lenders able and willing to take on the debt financing portion of Section 9003 eligible projects to plummet. Further, the proposed rule issued by the USDA in April 2010 to modify the 2008–2010 NOFAs did not provide enough comfort to the remaining pool of lenders that otherwise would participate in the program. As a result, the LNG program was not accomplishing what it set out to do as many bioenergy companies were unable to secure the crucial financing required to move their projects forward.

Some of the highlights of the interim final rule versus the proposed rule are as follows:

PROPOSED RULE/2008–2010 NOFAs	INTERIM FINAL RULE
Minimum retention requirement of 50% of the unguaranteed portion of the loan	Minimum retention requirement of 7.5% on the total loan amount
Maximum of 80% of total loan amount eligible for guarantee with 20% equity	Maximum of 90% of total loan amount eligible for guarantee if under $125 million and meets other requirements with 40% equity
Unspecified	Federal grants do not qualify as part of the 20% equity, while state and local grants will qualify
Repayment of the loan (guaranteed and unguaranteed) cannot exceed 20 years or 85% of the life of the project, whichever comes first	Repayment of the loan (guaranteed and unguaranteed) cannot exceed 20 years or the life of the project, whichever comes first
The unguaranteed portion of the loan’s interest rate cannot be more than 1% higher (absolute spread) than the guaranteed portion	The unguaranteed portion of the loan’s interest rate cannot be more than 5% higher (absolute spread) than the guaranteed portion
51% U.S. ownership requirement for qualified borrowers	No U.S. ownership requirement
Projects must be located in a “rural” area	Projects are scored higher/lower in their initial assessment based on location and “rural” is no longer a requirement but serves to increase a project’s score
More than 70% of refinery revenue generated must be from advanced biofuels	The majority of what is generated must be advanced biofuels
Very strict definition of biofuels	A bio-based product with a specified BTU content recognized by a federal agency can qualify as an advanced biofuel in some cases
Refinancing not qualified for loan guarantee	Refinancing will qualify for a loan guarantee under certain circumstances

Bond Financing and Section 9003

For the first time, cash-strapped bioenergy and bioproduct companies may use this bond financing to link up with the most sophisticated of institutional investors. Under the new rules, the traditional lender in the Section 9003 program (a U.S. regulated commercial bank/program applicant) becomes a trustee for the proceeds of a bioenergy or bioproduct company's bond sale to targeted private investors (at least $1 million net worth by SEC accredited investor rules, but generally more sophisticated institutional investors like hedge funds and pension funds), and in turn places the proceeds of the bond sale into the project. This mechanism essentially removes the limitations that bioenergy and bioproduct companies dealt with in years past by allowing more liquid and less risk-averse financiers into the equation, but at the same time fits within the original legislative intent of this loan guarantee program.

The bond financing structure is an improvement on the old system for a number of reasons. First and foremost, the bond market is substantially larger than the commercial debt market—more than $1 trillion annually available—providing firms access to a much larger pool of funds from an essentially untapped source. Second, bond financing presents an opportunity for companies to secure funds both at a lower cost and at longer tenors to permit proper project amortization. The bond financing structure requires larger and more sophisticated institutions to underwrite, perform due diligence, and market the bonds—all of which lend further legitimacy to the instruments themselves.

Bond financing also permits the trustee bank to participate with very little risk, unlike under the former 2008–2010 NOFAs, where lenders took on huge debt exposure on relatively risky projects. Finally, if additional or unforeseen costs enter the equation as the project advances, the project company only must place additional bonds to secure additional proceeds under this highly flexible funding mechanism, as opposed to seeking a new loan or increasing its existing loan. With these changes, USDA loan guarantees for advanced biofuel, and now bioproduct, projects are now more accessible and more attractive to large financial institutions best equipped to undertake such debt financing.

Awardees to Date

The USDA already has issued awards (pending finalization of the rule) to three companies: INEOS Bio received a $75 million conditional loan guarantee for its new eight million gallon per year integrated biorefinery in Vero Beach, Florida, Enerkem received an $80 million conditional loan guarantee for its 10 million gallon per year integrated biorefinery in Mississippi, and Coskata received a $250 million conditional loan guarantee for its 55 million gallon per year integrated biorefinery in Alabama. A fourth loan guarantee is expected to be issued shortly. All four companies will use a credit-enhanced 100% bond financing mechanism in lieu of commercial loans for their respective projects. The Mintz Levin, Stern Brothers, and Krieg DeVault team, along with Cindy Thyfault from Westar Trade Resources as the application drafter, worked with many of these companies to secure their conditional loan guarantees.

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For information on the program, please contact Mark J. Riedy at 202-434-7474.

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