CLEAN ASSET BONDS

Clean Capitalist Leadership Council
Turning capitalism into clean capitalism

ACEEE
American Council for an Energy-Efficient Economy

The Clean Capital Market & Pollution Free Enterprise Act

Clean Asset Bonds Build Big Clean Capital Markets, to Fuel No/Low Pollution Free Enterprise

Straw Proposal Draft, May 22, 2018

This is a draft federal "Clean Tax Cut" legislative policy proposal, for purposes of discussion, designed to solicit comments and suggestions. (For info on Clean Tax Cuts: http://cleantaxcuts.org/about)

Clean Tax Cuts (CTCs) are a new class of policy proposal that remove tax and other barriers to capital and participation for low-or-no pollution free enterprise, in order to drive broad-based prosperity and a cleaner world. Clean Asset Bonds (CABs), of all CTC mechanisms, may well do that best — in fact better, with broader impact, and greater leverage, than other incentives — as discussed below. These can unlock large new capital flows from untapped investors, to fuel innovative clean enterprise.

Clean Asset Bonds (CABs) – Definition & Advantages: As proposed, Clean Asset Bonds would be federally tax-exempt *private* green bonds (corporate and mortgage-backed) financing manufacture and deployment of legislatively pre-qualified clean assets, historically known for high-impact pollution reduction (e.g. any proven zero-emission power source). This unique design guarantees green impact and public benefit – without complicating easy, low-cost bond issuance.

Alone among incentives, CABs apply policy leverage (tax cuts) to financial leverage in private debt markets. They magnify classic leverage effects: cheaper cost of capital, faster growth, and higher return on equity (ROE). Significantly, CABs do so in the private U.S. corporate and mortgage bond markets, because that is where the real money is – the largest ($17.6 trillion) capital market in the world. Hundreds of millions of investors worldwide can be tapped through this one huge, inclusive market, optimized for free enterprise – in sharp contrast to the 70,000 small, fragmented, illiquid muni bond markets, designed for political needs, where each issue often appeals to citizens of just one city or state – a small niche market.

Magnified leverage in a vast private market drives multiple democratic, inclusive, high impact incentives that un-leveraged incentives cannot match. CABs directly offer a new, tax-exempt bond that millions of retiring baby boomers may want in their portfolios. But cheaper capital from CABs also leverages higher ROE, attracting big corporate and institutional investors, and also millions of middle income investors, to the higher taxable returns on the rest of the capital stack. So CABs could incent all kinds of investors (even those with no interest in tax equity or muni bonds) and could even drive new investment, not just in CABs, but in both taxable debt and equity securities, thereby increasing tax revenues.

Cheaper capital, via magnified leverage, can also make clean energy and products cheaper, more available and desirable to everyone, driving demand.[1] In this CABs act like a broad tax cut as cheaper clean energy spreads the CAB tax cut benefit to everyone. That will drive down costs and increase profits for, and tax revenue from many clean energy consuming business. So CABs, like most capital tax cuts, should generally increase profits, investment, jobs and GDP. Finally, in the long-term (beyond the current proposed pilot), CABs can apply broadly, economy-wide, with neutrality, to all pollution reducing technologies, and can address a variety of environmental issues.

These multiple broad-based advantages make CABs the ideal transactional building block for a very large, barrier-free clean capital market. Such multiple impacts can't be matched by other un-leveraged incentives. These advantages are the reason CABs form the essential core of this proposal.[2]

Six Year Pilot Program: We here propose a six year, metrics-based pilot program, authorizing the use of federally tax-exempt CABs (and similar, securitize-able, tax-exempt Clean Asset Loans (CALs)) to accelerate investment in a few key clean technologies and practices in the energy, transportation and real estate sectors, known to deliver well-defined, quantifiable pollution reduction impacts: *all low/no-emission electric generation and vehicles; carbon capture; combined heat and power; zero energy buildings; and hydrocarbon capture for oil & gas*. The pilot program starts there, because pollution metrics and control technologies are best understood for these sectors, and CABs can yield large impacts applied there.[3]

We propose CAB share of total financing steps down by 10 percentage points a year, from 80% of project funding in the first year, to 40% in years five and six. This will help kick start the use of CABs – and securitization in general, much needed for the maturing clean infrastructure sector. But the step down smoothly throttles back to encourage a steady increase in taxable investment, debt and equity, and federal tax revenue. This structure provides certainty for the market, and data to optimize CAB/capital structure going forward for environmental and economic impact.

Rough Draft Outline: We here offer a rough draft version of language that might be included in the Act, in order to lay out some specifics:

During a six year pilot program, interest on privately issued Clean Asset Bonds (CABs) and Clean Asset Loans (CALs) will not be subject to federal taxation. Proceeds from such bonds and loans must be used to finance a portion of the capital needed for projects that manufacture, purchase, deploy, or construct the following clean assets:

1. Electric generation sources that produce energy with zero direct emissions of mercury, SOx, NOx and greenhouse gases, including associated energy storage and control systems, and dedicated power lines needed to connect such power sources to the nearest substation; [Definitions from IRS Section 45 may be useful here.]

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1 Especially so, since CABs would further accelerate the already impressive tech driven cost declines we see for wind, solar, storage and efficiency, on top of cheap capital effects.

2 In addition, CABs increase GDP, and won't waste taxpayer dollars on failing business models. All CTCs employ targeted capital tax rate cuts, so remove "deadweight loss" and so increase GDP. Unlike other incentives, they only benefit profitable enterprise. CABs, by themselves, cannot prop up money losers.

3 In the future, Congress may consider CABs applied to other sectors and pollution issues, such as plastic waste, water pollution and scarcity, recycling, regenerative farming, etc., after studying the results of this pilot program.

2. A home or building or industrial plant that is designed to achieve net zero energy performance, as defined by the Secretary of Energy, by rule, and certified by a licensed architect or engineer (need to be able to show design calculations, not actual performance).
3. Factories and other property, plants and equipment used for the production and sale of: (a) zero-emission vehicles as defined by the Environmental Protection Agency by rule; (b) battery systems and motors for zero emission vehicles; and (c) hybrid powertrains for medium- and heavy-duty trucks.
4. Electric vehicle charging systems that can be used by the public.
5. Best Available Technology for reducing emissions from oil and gas production and distribution, as determined by the Environmental Protection Agency.
6. A combined heat and power system as defined under the Energy Improvement and Extension Act of 2008.
7. Power plants that capture at least 60% of their CO2 emissions, or facilities that capture CO2 from the atmosphere, and which either utilize the CO2 in durable products or store it for a century or more in accordance with criteria to be developed by the Secretary of Energy by rule.

Such tax-exempt CABs and CALs can be used to finance the following percentage of total project costs in each year of the pilot program: Year 1: 80%; Year 2: 70%; Year 3: 60%; Year 4: 50%; Year 5: 40%; Year 6: 40%. Use of tax-exempt CABs or CALs shall not prevent the use of additional similar taxable bonds and loans, or any other financing legally allowed.

The above mentioned Clean Asset Loans, paying tax-exempt interest may be combined with other similarly tax exempt CALs and re-sold as CAB debt securities, whose interest will also be tax exempt for holders of those securities.

The purpose of the above provisions is to create a large, barrier-free clean capital market to better finance the accelerated deployment of the above listed clean assets. Since these purposes are best served by making that market as large as possible, one option is to invite foreign nations to join this market on the basis of reciprocity. Interest on privately issued Clean Asset Bonds (CABs) and Clean Asset Loans (CALs), issued by the taxpayers of the United State of America or any cooperating nation, will not be subject to US federal taxation, or taxation by any cooperating nation.[4]

The Secretary of the Treasury shall develop procedures for reporting use of proceeds, expenditures and income from such clean assets, projects and investments to the federal government in order to help with the evaluation of this pilot program.

Two years after the tax cuts begin, and every two years thereafter, the Secretary of the Treasury, in consultation with the Administrator of the Environmental Protection Agency and the Secretary of Energy, after providing an opportunity for public comment, shall report to Congress on the costs and benefits of the tax cuts and any recommendations for refinements of these provisions.

4 To enter into such reciprocal cooperation with the U.S. , any foreign nation would need to enact their own legislation with provisions identical or comparable to the US legislation except applying to their own national tax laws and subject to oversight by their own governmental agencies, and also specifically providing that interest on privately issued CABs and CALs, issued by US taxpayers and taxpayers of other cooperating nations, will not be subject to their national taxation. To facilitate such reciprocal cooperation, Act sponsors might consider including a provision that sets out a process to negotiate and agree on mutual recognition of tax exemptions for CABs and CALs, including minimum conditions for such recognition. This could be coupled with reciprocal lowering or elimination of tariffs levied on the above listed clean assets to optimally reduce all barriers and level the playing field.

In carrying out all these duties, the Administrator of the Environmental Protection Agency and the Secretary of Energy shall focus on environmental and energy sector impacts and pollution costs avoided, and The Secretary of the Treasury and the Department of the Treasury shall focus on financial, fiscal, economic and market aspects of this program, drawing upon financial conclusions reached by the Administrator of the Environmental Protection Agency and the Secretary of Energy as a result of their analysis of environmental and energy sector impacts.

Issuers of CABs shall follow the Green Bond Principles, as published by the International Capital Markets Association in January, 2018, with respect to such bond issuance, at least to the extent consistent with compliance with this Act. If some CABs allowed under this act are not allowed under 2018 Green Bond Principles, the issuers of such CABs should nonetheless abide by 2018 Green Bond Principles to the extent they can, even though such CABs might not be labeled as Green Bonds.