U.S. EPA Environmental Financial Advisory Board: Pollution Prevention Finance Forum
Tuesday 8/23/2022 12:00 PM - 1:30 PM ET

<u>Welcome remarks</u>

Edward Chu, Designated Federal Official for EFAB – Welcomed all to the third workshop of the EPA EFAB's Pollution Prevention Finance Forum. Noted that this workshop is informational in nature for the EFAB's Pollution Prevention Workgroup and its EPA client, the Office of Chemical Safety and Pollution Prevention. It does not represent the full view of the EFAB, and information and viewpoints discussed are not the views of the agency. For the Federal Register Notice, they are not accepting oral public comments during the workshop, and they received no written comments prior to this workshop. Noted that the meeting is public and being recorded.

Ashley Allen Jones, iCapital, EFAB Chair – Welcomed all to the workshop and introduced herself as the moderator for the workshop and introduced the speakers. Noted the history of the workshop series which began in November of 2021 with the goal of exploring barriers to and identify potential solutions for financing sustainability efforts in the middle market manufacturing sector, with a specific focus on food and beverage, automotive, aerospace and defense, fabricated metals and chemical manufacturing. Pointed out the importance of these sectors and the need to prevent pollution as well as the opportunity that exists for change in reducing the gap between financial service providers and middle market businesses needing assistance.

David Widawsky, EPA – Welcomed all and thanked participants, panelists and the EFAB team. David then reviewed the concept of pollution prevention and the Pollution Prevention Act of 1990. Most recently, EPA has been working on focusing on the manufacturing sectors that were mentioned above, and really focusing on those SMEs that are engaged in manufacturing and are facing some challenges and also opportunities. The P2 grant program has been around for many years and through that program EPA has learned that sometimes capitalization of adopting P2 practices through equipment or technology can be capital intensive and financing barriers arise. Because of these barriers, EPA came to the EFAB to try to explore creative approaches to identifying opportunities for capitalization, different kinds of structures and methods and mechanisms for doing so, and how one could potentially deliver the financing necessary to adopt pollution prevention and engage in capitalization and service the debt that might come with those capitalization activities.

Ashley Allen Jones – Gave a quick review of previous 2 workshops for which recordings can be found on the EPA's P2 website.

- The first workshop included presentations by finance sector professionals who addressed barriers and risks associated with P2 lending from both the borrower and the lender perspective, as well as different financing tools and structures that exist or could be developed to address these risks.
- The second workshop moved into more detail on standards and third-party certification, how it can provide a level of assurance around specific technologies and technical approaches that could give lenders comfort.

Ashley introduced the focus of this third workshop as the glue that creates opportunities and deals in this marketplace, or the cooperative fabric that we work from both a corporate strategy perspective, an OEM supply chain perspective, state level perspectives, as well as community development finance perspectives. This includes how we can start to understand and build the connectivity that allows these deals to happen.

Panelists

John Cox – Principal with John Cox Consulting
Martin Chilcott – CEO and Founder of Manufacturer 2030
Sarah Lee – Advanced Manufacturing Sector Integration, Washington State Department of Commerce
Frank Altman – CEO, Community Reinvestment Fund

Discussion

Q: John, as a CEO, tell us how you think about sustainability, how you have thought about sustainability as a matter of strategy and how businesses that you have run in the past have funded and implemented high priority sustainability projects.

A: (John) I would say to think of it in terms of continuous improvement. The idea of thinking about your value stream and where the waste is in that value stream is core to the ways that I've learned to approach this issue. I would summarize three perspectives: first, look for the intersection of waste and the sustainability issue that you're after; second, if you can't find the intersection, work hard at finding one because if you work at it, you can figure out how to eliminate the waste profitably; third, keep your eyes and your ears open for things that other people value that you may not necessarily value and look for opportunities to partner with them.

Q: Martin, you work with OEMs to help them meet their scope 3 carbon emission targets and otherwise. Could you tell us a bit about how your work empowers OEMs and their suppliers to make operating changes and specifically focus on the middle market that might be further down from the tier one OEM suppliers into the smaller business sector?

A: (Martin) Manufacture 2030 works with global corporations to help them reduce carbon in their supply chains, but really the work we do is with the suppliers. You start cascading down through the tiers to small and medium-sized manufacturers who face three challenges if they're to drive decarbonization: 1) Priority - Is it a priority for their business to invest time and effort and capital and technology in decarbonizing? 2) Know how - Do they have capacity and knowledge and understanding inside their organization of what to do? 3) Access to capital and where capital is needed for projects. What we do that's unique and interesting and seems to be unlocking a lot of improvement is we both help the suppliers at a manufacturing plant level measure their footprint, but more importantly, build an action plan. We call it a climate action plan. Then Manufacture 2030, with our platform, can see across currently about 5,000 manufacturing sites. We can see all these plans that look out three to five years into the future and we can see what people need to invest in.

Additionally, we see companies very often limit the business case just to the spot price (the cost or price at just one point in a life cycle). Whereas the value that these projects create are often many layered, and you need to stack many different ways in identifying the value – throughout the lifecycle of a product or the full manufacturing process. It is important in supporting the SMEs to become sophisticated valuers of the project, identified as a value in the project and sophisticated financial project managers.

Q: Sarah, you work on policies, strategies and investments to grow Washington State's manufacturing sector, and I know you focus specifically on sustainability initiatives as part of that work. Can you address some of the ways that you work with middle market manufacturers and some of the sustainability objectives that those manufacturers have?

A: (Sarah) I'm a connector and it's business and communities farthest from opportunity and impactful government programs like this that need funding. There are philanthropists looking to invest money, but they are not and it's because the businesses and the programs are not investment or investor ready or worthy. The reasons can be as basic as not even knowing that certain government grants exist, not having the financial information that's required, lack of trust in the process, not having the time or capacity or the language or a computer to apply for a grant. In addition, the philanthropists, or funders, are not business ready because they don't know or trust the government systems. Thanks to a grant from the US Economic Development Administration and help from experts around the country, we have been chipping away at this issue. And we have demonstrated that strategic targeted partnerships with the private sector can attract private funding and philanthropy to leverage these grants. My advice: 1) find the specific gaps and fill them. What are the gaps preventing businesses from being investor ready? 2) find out who the different funders are and how to speak to them. What do they need? What do they want to invest in? What kind of financial vehicles, funds, loans, match, loan guarantee that they need?

Q: Frank, I'm curious, how have you worked to fill these gaps in access to capital for middle market companies, both in Minnesota as well as nationally? Talk a little bit about how you filled the gaps.

A: (Frank) The gaps and being able to talk to investors and businesses, we've found a way of doing that and bringing some scale to the effort. As background, we are a CDFI, Community Development Financial Institution. These are organizations that are certified by the United States Department of Treasury that have a target market, that is either low-income targeted populations, low-income people, or low-income places, mostly census tracts and/or other targeted populations, which tend to be people of color in various communities around the country. Being able to bring scale to these organizations is a challenge. But we have done this by networking organizations in a variety of ways through partnerships. When the PPP came out to generate loans to sole proprietorships, we were able to get capital to flow to those communities because of the network of community development financial institutions that were out there that wanted their customers to get access to this program. Our mission is to help people improve their communities and strengthen their communities and improve their lives through innovative financial solutions. For example, we did create a secondary market for community and economic development loans using public, private and philanthropic resources to access the capital markets at scale. We also pioneered the Federal New Markets Tax Credit, which has been used to finance a number of SME-type businesses that are right in the sweet spot of our discussion today.

Our industry is concerned about those people that are farthest away from opportunity, and bringing the impact investor into this discussion is very important. We know that there is a rising demand among particularly the next generation of asset-owners to have an impact beyond simply making a financial return. Many of those investors are interested in environmental improvements and reducing climate emissions and climate change. They're also interested in low-income communities, and in many cases, the communities where they grew up. So being able to marry the climate justice with economic opportunity for low-income communities is a challenge and opportunity I think that we need to be focused on as we move forward. In addition, if we're going to move to a clean economy and get away from carbon, there's going to be a huge amount of work that has to happen in terms of retrofitting commercial buildings, commercial processes, as well as residential. And there's a whole army of people in the contracting world that are ready to go. They need financing.

Q: (To all) What specifically does a partnership or a collaboration look like as it's getting started? Is it a unique brand? Is it a technology label? What does that look like in practice in each of your situations?

A: (Frank) In the community development financial institutions sector, our trade association uses the term the "capillaries of finance". We get dollars to the very difficult places that capital doesn't want to flow. And we do that through financial engineering primarily. The issuance of the use of guarantees both from the philanthropic community and from government is really important to building financial assets that can be invested in. What we're trying to do with SBA is to take that tool and point it toward those people who don't necessarily have access to conventional financing even through their bank. The ability for a CDFI to have cultural competency, to have trust in particularly communities of color, recent immigrants and others where there is a tremendous amount of entrepreneurial drive, but not necessarily the ability to know how to trust the institutions that we have, CDFIs can fill that cultural competency issue. I would also say that if we look at this as a network, there's a potential to do a lot in this space of pollution prevention. Regarding the technical assistance programs of the EPA and others, there is technical assistance that is delivered by CDFIs. It may not be the kind of assistance that EPA is delivering but maybe there's a nexus there for a partnership.

A: (Sarah) One of the things that we did at the very beginning, two years, ago was created a donor-advised fund. We told people, "This is what we're using in the Safe Start grant, this is what we're using it for." And then we went to folks who wanted to put money into it as a tax write-off there was impact. It helped us learn more about what the folks in the private sector wanted and we were able to match our grants. So let's say you have a pollution prevention grant, you can also match it with our Safe Start fund, one to one. In terms of how do you pull people together? We have a philanthropy advisory board which is going to keep pushing us as to what the market is interested in.

A: (Martin) Here is an example of how things might work -- a bunch of suppliers build their climate action plans for reducing their emissions and some of them are going to put in things like onsite renewables or they can do various efficiency programs. Some of those projects are going to be qualified for finance. Most of those companies will be qualified in themselves because of the nature of their relationship with their OEM. They may be pretty small, but if they are intrinsically important to the OEM, then the OEM gives them their blessing and support and they become a qualifying company which brings smaller companies into the remit of the program. Then we support those suppliers with capacity-building programs that help them understand how to build a business case, how to understand that value stack, how to justify the investment, and therefore, how to secure it. Also, in a more complex system, we're looking at other ways to share costs across supply basis so that small and medium-sized manufacturers can get access to technologies and research on technologies that would, for instance, decarbonize high temperature thermal processes. We're looking at how can we pilot, how can we share the cost across large numbers of supply sites to pilot a technology, to share the data, to accelerate the technologies to market, by signaling to investors that there is a lot of demand for the technology, to ultimately drive down the price to the supplier.

A: (John) Our standard work is built around a standard internal rate of return threshold. We have a target that we're trying to get to as an organization. Anybody within the organization, if you can bring a project with an internal rate of return of X, we're going to figure out how to fund it. The way that we have tried to amplify our ability to do that has been to educate as many people in the organization as possible. We taught continuous improvement to everybody in the organization; this will help people see opportunities and generate projects that have a great internal rate of return. From a strategic leadership standpoint, our business unit leaders know I expect them to be searching and using continuous improvement to find projects. This really can wrap around the idea of if something is good for society; while we may not be able to get a complete internal rate of return that is satisfactory to us, are there resources outside of us that would have an interest in us doing the right things.

Q: When does a project become too complex for these types of solutions, through say technical feasibility? Have you come across any projects that have given you pause or a hard stop that they're just too technically complex to see any reasonable implementation or a rate of return?

A: (Sarah) One thing that just kills a lot of these programs at the very beginning is there's no predevelopment dollars and there's no patient capital for those predevelopment dollars.

A: (Martin) I think this is in part an issue of timing and a competing relationship between strength and motivation and complexity/cost. It's not just a return on investment calculation; it's actually what is motivating, how strong is that motivation within an organization. We're learning you can share the cost and the complexity. There are ways of reducing the perceived costs and the complexity which makes it more likely that projects go ahead. I would absolutely emphasize the importance of corporate motivation being essential to overcome some of the challenges in more complex projects and more complex project finance.

A: (John) I think people tend to move right past good planning and good thinking on the front end and into problem solving and they find themselves lost once they get there. The way we talk about it organizationally is, "Have a good charter at the outset." And when you really work at that charter, if it's too complex and you say, "This is just going to be too complex, I'm afraid." Then ask yourself, "Well, how would I apply continuous improvement principles here? How would I break this into a piece that we could tackle first, and if successful with that, would lead us to the next piece?"

A: (Martin) I would reiterate it's really important to understand what the value is, really understand having the capacity and capability to write the business case, that is as important as the availability of the money that's required.

Q: Frank, where do you see technical complexity in hindering or streamlining the underwriting process?

A: (Frank) We actually embrace the complexity because that's how we get the capital to flow and it's a challenge. I think being able to understand where the market is and build the products that are responsive to the market, both on the demand side for the businesses that are looking to finance these improvements, as well as on the investor side, is the challenge. I also think there are a number of efforts around the financial engineering and financial innovations.

Q: Given the network that you've described, Frank, could you imagine, through the CDFI network, a sectoral intervention using a productized approach?

A: (Frank) There definitely is opportunity there. There's no reason why there can't be a focus on small manufacturers.

A: (Sarah) We have an innovation cluster accelerator program and one of the things that we've done is to choose innovative cluster potentials that we can grow in Washington State. One of them is 5G and trying figure out what are the applications of 5G when it comes to agriculture.

A: (Martin) Our approach is already sector based. We work with one industry at a time. One of the things we haven't done yet, which we're interested in doing, is to see if we can overlay our industry approach with a state or regional base. It could be state organizations or education organizations to increase scale and drive down costs even further.

Q: What have you experienced in terms of bringing and eliciting wraparound support on a continuing basis so that we're not doing drive by financing and drive by financial support that will help continuing support for continuing improvement? And what do those kinds of entities, further away from opportunities, need on a continuing basis to realize those kind of financing successes and business successes?

A: (Sarah) The wraparound service is absolutely critical. You've got to have people paying for this and the metrics to show results.

A: (Frank) We are working hard to match the borrowers that are coming into these programs looking for financing to CDFIs that have products that can support them. And we do that through a platform that we've developed called Connect to Capital. The next version that we are building is connecting people to technical assistance.

A: (Martin) I think one of the things we've got to learn to do is bring the whole carbon finance mechanism that we wish to use to unleash the progress we need into the business. And this is a really good example of how companies are going to want to use trade or supply chain finance.

A: (John) When you talk about meeting people where they sit, I can tell you that from the advantage point of somebody within manufacturing, most people come talk to you and they talk about what interests them. And I would just challenge you to try to figure out what interests the business. If you start the conversation with, "It's a carbon problem," people stop listening. So come and say, "What problems do you have? How can we help you with those?" And reframe it within language that they understand and you have a better chance of getting them to buy in and look at your priorities too.

Conclusions:

Kerry wraps up the session thanking everyone for a great conversation and great examples to illuminate:

- The notion of continuous improvement and expanding the definition of ROI and value stacking, and how that can ripple through a supply chain.
- The need to focus on these communities that are farthest away from the opportunity and innovative strategies to bring in other resources to put solutions together and meeting them where they are, recognizing time, trust, technology are an issue and the need for nontraditional financing strategies.
- The network of 1,000 CDFIs, the capillaries and how we can leverage them, and how do we take more of a sectoral vertical approach to bring all these pieces together to drive the impact we're looking to drive in these seven different sectors that this work group is focused on with EPA.