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**INNOVATIVE FINANCING: BANKS AND ENERGY
CONSERVATION**

Final Report

**October 1977
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FINAL REPORT

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ERDA CONTRACT NO.
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PREFACE

This report is organized in a question and answer format for easy reading. For the reader with little familiarity with conservation issues, Questions 2, 3, and 4 summarize important observations about the marketplace for conservation programs. For those with limited understanding of banks, Questions 5 and 6 provide a brief overview of their attitudes and operations. Readers only interested in what banks are doing now in energy conservation, or could do in the future should go immediately to Questions 7, 8, and 9. Finally, Question 10 deals with issues mainly relevant to the policy-maker in ERDA and in the banking industry -- issues of strategies designed to assure early implementation of new programs and to build awareness of energy conservation in financial institutions.

This report describes the results of a project that examined what commercial banks could do on their own to encourage energy conservation in existing residences. The recommendations made herein reflect the present realities of both the commercial banking sector and the marketplace for energy conservation technology.

Stated briefly, these realities include the following three key points:

- Banks have limited interest in promoting energy conservation. Banks are not particularly interested in the purposes for which their customers borrow money, as long as the borrower repays the loan on the agreed terms.
- Even if banks were interested in encouraging conservation, the economics of their operations limit their opportunities for radical improvement in the terms that they can offer consumers. Alterations in interest rates, terms of maturity, amounts available, repayment format and the like are likely to be marginal at best. Banks do compete -- with each other, with savings and loan associations and with credit unions for the most desirable market areas. Even in areas where the consumer demand is more pronounced than that for energy conservation, few dramatic innovations in the "lending equation" have emerged. Competition is marginal and incremental, indicating that major changes in terms may simply not be practical.
- Consumer demand for financing of energy conservation is derived, not primary. Consumers do not utilize bank services for their own sake, but rather as a means to acquire some other good or service. Banks have a limited ability to promote the primary item (in this case, conservation hardware). In fact, the manufacturers, retailers, installers of such items and utility companies have more of a direct vested interest in promoting consumer demand for these kinds of items than do financial intermediaries.

In other words, seen in the context of the banking industry, the role of banks (acting without public subsidy) will be that of offering modest, rather than dramatic changes in present practices and bank services. It is most unlikely that banks will offer, for instance, interest-free loans or cash grants. Their strongest role will be to facilitate the translation of consumer demand into acquisition of suitable hardware in as convenient and easy a fashion as possible, so that financing does not become a bottleneck or obstacle to widespread energy conservation.

It is, therefore, important to state at the outset that while there is obviously a place for new ideas, the issue is less how to get banks to do more in the way of dramatic new ideas or programs than how to get more banks to do what is already being done by a small number of their counterparts around the country. There are few radical suggestions in this report. This does not imply that the recommendations made are unimportant or trivial. On the contrary, we believe that implementation of the conclusions of this research could significantly advance the cause of energy conservation in the residential sector.

QUESTIONS AND ANSWERS

(1) WHAT IS THE PURPOSE OF THIS PROJECT AND THE BASIS OF ITS CONCLUSIONS?

To identify opportunities for innovations by commercial banks that will encourage residential energy conservation -- new financing services; new applications of existing services or new roles for banks. The RERC team reviewed relevant literature and contacted bankers and bank trade associations, working with a team of selected bankers from the First National Bank of Chicago, RERC's parent corporation.

(2) WHAT ARE CONSUMERS SUPPOSED TO DO?

To acquire a wide range of items which conserve energy in the home, most costing from \$5 to \$1,000, individually or in combination; some moveable, some built-in; some needing to be professionally installed, some do-it-yourself.

(3) WHY WOULD CONSUMERS WANT TO ACQUIRE CONSERVATION ITEMS?

Most promotion of conservation has stressed sacrifice, patriotism, and cost savings to consumers. There are other powerful motivations -- for example, increased comfort or threatened curtailment of energy supplies. In contrast, there are significant barriers to consumer acceptance -- apathy, inconvenience, skepticism and ignorance. Currently, consumer demand for energy conservation hardware is limited and episodic.

(4) WHEN AND HOW DO INTERESTED CONSUMERS ACQUIRE THESE ITEMS?

When making major appliance choices, remodelling, or changing residence. They buy, rent or lease items by using current income, prior savings or borrowed funds, or they receive items as gifts or by barter.

(5) WHAT DO BANKS DO, AND HOW ARE THEY INVOLVED IN CONSUMER ACQUISITION OF CONSERVATION ITEMS?

Most banks offer a similar product line -- deposit services (checking and savings accounts), lending services (credit cards and loans), and other services to individuals and corporations. However, banks differ widely in their operations, depending on their size, location, and operating style. Banks are directly or indirectly involved in almost all consumer transactions.

(6) WHY WOULD BANKS BE INTERESTED IN PROMOTING ENERGY CONSERVATION?

Banks might develop energy conservation programs as a bona fide business opportunity; a way to reduce energy-related loan losses; a loss leader for other services; a public relations gesture; or to forestall increased government involvement in bank operations.

(7) WHAT HAVE BANKS DONE SO FAR?

Very little. Only a few banks have developed specific programs to encourage residential energy conservation and most have enjoyed only limited success.

(8) WHY HAVEN'T MORE BANKS DONE MORE TO ENCOURAGE ENERGY CONSERVATION?

While banks are not against energy conservation, neither are they especially interested in promoting it aggressively. Conservation retrofit investments in the \$200 - \$1,000 range are neither particularly attractive nor financially feasible as high priority bank business opportunities. In addition, many banks view their role as responding to the marketplace rather than leading it. Aggressive conservation progress may involve changes in role and practices which many banks are reluctant to make. Banks are largely unaware of what has been done in this area, and find the inconvenience of designing their own conservation programs a significant barrier.

(9) WHAT MORE COULD BANKS DO?

Banks can encourage energy conservation by making some changes in their current operations. These changes, while relatively modest, are nonetheless important and could take place in the areas of marketing and promotion, direct lending, indirect lending, credit cards, savings and time deposits, and checking accounts.

The opportunities for innovation below that are deemed most promising as demonstration programs are marked with a star★ and are described in more detail in the body of the report -- Chapter 9, page 54.

As marketers, they could:

- Capitalize on free publicity and news media interest by early entry into the energy conservation field and thereby generate a positive public image at little, if any, cost.
- Modify advertising messages to reflect conservation themes, "Put Batts in Your Belfry," "The Housewarmer Loan," "The Cost Cutter Conservation Loan," "Watt Watchers," etc.
- ★ Develop add-on loan business with all new home improvement and mortgage borrowers by offering favorable loan packages for conservation investments (e.g., add \$500 for insulation on a home improvement loan originally planned only for a new roof).
- Develop "after markets" for especially favorable conservation home improvement loans, i.e., among bank customers with existing mortgages, established good credit ratings, or those about to pay off a prior loan.
- ★ Directly offer lower-cost conservation items (shower flow restrictors, weatherstripping, clock thermostats, etc.) as give-away premiums to new checking customers, or as "in lieu of interest" incentives to new savings account customers, or partial or self-liquidator items which customers can purchase at special discounts.
- ★ Develop "piggyback" marketing campaigns to take advantage of public sector financial incentives like tax credits, property tax deductions or private sector inducements like manufacturer discounts. These could be modelled after bank and savings and loan association promotion of Keogh and IRA accounts.
- ★ Develop coordinated marketing strategies with utilities, insulation contractors, and conservation hardware outlets to provide interested consumers with convenient, "one-stop" shopping for advice, financing, installation, and servicing of conservation items.
- Target bank incentives on high-potential consumer groups such as home remodellers, do-it-yourselfers, recent movers, those threatened with fuel cut-offs, members of groups with ecological concerns.
- Use bill and account statement stuffers or specially-printed forms to promote conservation services and investments to credit card, checking, savings, and loan customers.

- Provide retrofit tools, e.g., staple guns for insulation, on loan to conservation investors.
- Conduct/sponsor "How-To-Insulate-Your-Attic" or "The Five Point Energy Savers Program" workshops at bank branches or at community locations for corporate advertising purposes.
- Sponsor an energy conservation award by giving certificates to companies, employees, or individual customers who come up with energy conservation ideas or who make significant energy savings in their office or home.
- Provide display space in bank lobbies for conservation literature (such as the HUD pamphlet, "In the Bank Or Up the Chimney," how-to-do-it information, lists of participating retail outlets and installers of conservation items).

As direct lenders, they could:

- ★ Give flat rate interest reductions on personal and home improvement loans for borrowers investing in specified energy conservation projects.
- ★ Give variable rate interest reductions to encourage borrowers to "package" energy conservation items rather than buy them singly ("The More You Buy The Lower the Rate").
- ★ Offer cash rebates to conservation borrowers.
- ★ Offer in-kind premiums ("We'll Buy Your First Roll of Insulation") or coupons (redeemable at participating retailers) to energy conservation borrowers.
- ★ Offer reduced rate mortgages for purchase or refinancing of homes meeting energy-efficiency standards.
- ★ Offer mortgage "add-ons" to cover incremental costs of upgrading homes to qualify for reduced rate mortgages.

- ★ Reduce downpayment requirements for borrowers meeting certain conservation criteria.
- ★ Develop a special rate mortgage program for new homes constructed by cooperating builders with special conservation features.
- Modify existing residential appraisal procedures to include estimates of energy costs in addition to standard items like insurance, taxes, etc.
- Include in normal credit eligibility formulae evaluation of energy costs.
- Offer to donate \$25, or an in-kind equivalent, (park bench, tree) to the Sierra Club, Kiwanis, Lions, Boy Scouts, or a specified charity, for every person who takes out a conservation project loan and indicates the sponsorship.
- Offer favorable loan terms by:
 - Reducing origination costs -- by having someone else (an employer, a utility, a government agency) take many of the initial steps, such as credit checking, application forms, advertising and promotion.
 - Reducing servicing costs -- by reducing the number of payments, e.g., quarterly rather than monthly; having someone else collect the money (employer through payroll deduction); having delinquency notice or default/collection procedures done by someone else.
 - Reducing loan losses -- by only dealing with "low risk" consumers using very high credit eligibility standards or having consumers pre-qualified or "guaranteed" by another organization, e.g., a loan insurance program.
 - Increasing loan size -- by offering to finance "packages" of energy conservation items, the total of which is over \$1,000, or by bundling small loans into packages of \$100,000 or more.
- ★ - Reducing risk and/or exposure -- by forming an "energy conservation loan pool" on the model of the "high risk loan pools" for housing rehabilitation for lower income consumers; reducing commitment of bank funds to what may be a losing or minimally-profitable venture by joining with other lenders to set up a revolving loan pool available to conservation investors.

- Develop "compensating balance" relationships -- offer special low interest rate loan programs to employees of corporations that keep substantial checking account balances with the bank; establish compensating balances with municipalities or state government that allow banks to offer special energy conservation loan programs to all qualified applicants.

And as indirect lenders, banks could:

- ★ Banks could provide a line-of-credit to contractors and, in addition, could identify a group of reputable contractors (and possibly retailers to deal in the do-it-yourself market), and develop common financing packages with forms geared to particular types of retrofit projects and marketed by both parties. This could involve a tailoring of the financing technique to the scale of conservation project undertaken: offering bank credit card conveniences for \$300 and under projects (clock thermostats, attic insulation, water heater insulation jackets, etc.); a simple form and procedure like a "phone-in loan" desk for \$750-\$1,500 projects (furnace replacements, full insulation, storm windows and doors, etc.), and a special discount home improvement loan for larger expenditures. Banks could promote their part of such a program through lobby displays, brochures, bill stuffers to checking and credit card customers, and distribution of lists of participating contractors and outlets. Contractors would stress their portion (diagnosis of structure, selection and installation of hardware).
- ★ Banks with large numbers of employees and/or multiple branches could involve their own employees in energy conservation programs by offering employee discounts, bulk-buying and payroll deductions. This might work especially well for bank holding companies and could be incorporated in marketing messages to outside customers.
- ★ Working with large employers or other groups, banks could offer attractive financing packages for conservation projects. Such arrangements could include payroll deduction and/or automatic deposit of payroll checks to reduce bank costs. These channels offer a convenient method of reaching and servicing a low risk, large, and stable market segment. Insurance companies, phone companies, utilities, government agencies, and others could be potential partners in such a bank venture.

- Provide traditional indirect lending support to utilities on a transaction-by-transaction basis, with the utilities doing the program marketing and credit checking. The bank would provide the credit to each utility consumer/borrower as approved. Utilities might perform the servicing function, but this would require modifications to the normal billing and accounting systems used by such companies, and would leave open the issue of handling delinquencies or default.
- Extend a large "line-of-credit" to a utility company in much the same way financing a major capital expenditure program would be handled. The utility would use this credit as a loan pool from which it could offer favorable and convenient financing to individual consumers for energy conservation retrofit investments. This could involve one bank, or a consortium of participating banks, depending on the aggregate amount of funds required. Banks would not be directly involved after the initial large transaction with the utility.
- Banks could provide financing for a public "insulation district" similar to a special purpose district for sewer or sidewalk construction, or for undergrounding utility lines. Such a district could allow residents within a confined geographical area the benefits of economies of scale and convenience in selecting qualified installers. Bank financing would provide the capital for such a venture, with individual residents repaying low-rate loans on a yearly, or other basis through the district.
- Banks could identify qualified and reliable installers of conservation items, and provide start-up venture financing to enable such firms to increase their conservation retrofit businesses, in line with increasing consumer demand. This could also provide the bank with a place to refer customers of special bank conservation programs for competent assistance.

(10) WHAT WILL IT TAKE TO GET THESE THINGS DONE AND WHAT SHOULD ERDA'S ROLE BE?

Given the nature of banking and the questionable state of current consumer demand for conservation, banks are unlikely to do a great deal without outside assistance and encouragement. ERDA, working with individual banks and through key industry channels (e.g., the Bank Marketing Association, the American Bankers Association, and their state counterparts), should provide such assistance in the form of:

- Creative packaging and dissemination of current experience and possible new program ideas to make it easier for banks to initiate conservation activities. This should take the form of:
 - Development of a series of "Bankers' Kits" with conservation program ideas and materials tailored to suit the characteristics of different types of banks -- the "passive" bank (non-innovative, interest in conservation mainly geared to public relations), the "active" bank (willing to experiment with one-time special promotions or favorable rates and terms for energy conservation financing innovations), or the "lighthouse" bank (innovative, sophisticated marketer, interested in conservation for multiple reasons).
 - Designing and conducting a series of regional workshops offering information and technical assistance to invited bank officials, with sponsorship shared between federal and state government and appropriate banking industry groups. These workshops would be organized and conducted by a circuit riding team knowledgeable about specific conservation program options and implementation strategies.
 - Developing concise case studies of specific bank programs, including samples of materials of use to other banks like ads, loan application forms, training procedures, etc. Summaries of such case studies could be published in bank trade journals.

- Demonstration of alternative bank conservation program strategies in more locations to expand the base of experience and increase the visibility of these activities in the banking industry and the consumer marketplace. This would entail:
 - Identifying leading banks in major market areas, assisting them to replicate in their settings promising programs already adopted by other banks, and to explore new program concepts.
 - Identifying key market opportunities where banks or consumers are likely to be unusually interested in conservation because of recent events -- energy shortages, dramatic fuel price hikes, unusually cold weather, new and/or dramatic public sector initiatives (tax incentives, grants), or other factors. Program development and technical assistance efforts would be concentrated to take maximum advantage of these special circumstances.
- Build a broader constituency for conservation activities within the banking industry by working with trade associations and publications at the national, regional, and local levels to increase visibility and legitimacy of conservation programs by banks. This could include development of key supporting materials which banks could use in program initiation, and building supportive relationships with other key industry groups with which banks might cooperate in the conservation area, e.g., utilities, home improvement contractors, and manufacturers. In addition, ERDA should reward bank leaders in this area with public recognition, e.g., the "ERDA Award for Conservation Leadership" or the "President's Citation for Energy Leadership".

QUESTIONS AND ANSWERS

1. WHAT IS THE PURPOSE OF THIS PROJECT AND THE BASIS OF ITS CONCLUSIONS?

TO IDENTIFY OPPORTUNITIES FOR ENCOURAGING RESIDENTIAL ENERGY CONSERVATION THROUGH INNOVATIONS BY COMMERCIAL BANKS -- NEW FINANCING SERVICES, NEW APPLICATIONS OF EXISTING SERVICES, OR NEW ROLES FOR BANKS. THE RERC TEAM REVIEWED RELEVANT LITERATURE AND CONTACTED BANKERS AND BANK TRADE ASSOCIATIONS, WORKING WITH A TEAM OF SELECTED BANKERS FROM THE FIRST NATIONAL BANK OF CHICAGO, RERC'S PARENT CORPORATION.

This project sought to identify opportunities for innovative financing mechanisms or practices which commercial banks might develop to encourage greater utilization of energy conservation products within existing homes and apartments. The scope of our study was designed to complement a parallel effort conducted for ERDA by the National Savings and Loan League. The rationale for both stems from a perception by ERDA officials and other policy-makers that the lack of such innovative financing alternatives poses a significant barrier to broader consumer demand for energy conservation hardware. As structured, this project was limited to examination of such innovative opportunities by commercial banks, acting without public subsidy. Bank innovations could take one of two fundamental forms in this context:

1. They could facilitate the acquisition of energy conservation hardware by consumers already interested and motivated to make such investments;
or
2. They could stimulate consumer interest in and demand for energy conservation hardware among those not previously planning to invest in such items.

Innovativeness is relative, and depends in large part on how the particular innovation differs from the traditional practices or activities of the setting into which it is introduced. What is radical in one setting may be quite passe in another. No matter how novel a product or idea may be, its effectiveness in improving existing circumstances is directly proportional to how quickly and easily it can be adopted by the people who must make it work, and how well it is understood by the people who will use it. Research on the successful diffusion of innovations suggests that for innovations to be widely adopted, they must be:

- compatible with the practices and attitudes of the intended adopters;
- consistent with the constraints and resources available to those parties;
- convenient for the adopter to initiate, adopt, and modify; and
- credible to the potential adopter.

These concepts have been integrated in the approach to this project, which has kept an eye not only on the design of innovative financing techniques, but also on their prospects for successful adoption among commercial banks.

Given the nature of banking and the present attitudes of banks towards energy conservation, effective innovation in bank financing of conservation investments is likely to be incremental rather than dramatic, and concerned with improved methods of applying existing product lines to conservation purposes, rather than the design of wholly new financing instruments or technological breakthroughs. This reflects the basic conclusions drawn from our research, which suggest that the particular features of the financing instrument itself (its interest rate, maturity, amount and repayment terms, etc.) may be less important than the manner in which that instrument is offered and delivered to the potential consumer.

The findings and recommendations presented in this report are based on the following activities:

- Review of relevant literature and research dealing with the primary issues of this project, i.e., the commercial banking industry and bank operations, consumer attitudes and behavior regarding energy consumption and conservation, characteristics of conservation hardware, private sector financing mechanisms, and the nature of the residential sector and "retrofit" industry within which conservation investments are made.
- Contacts with representatives of national banking trade associations, state banking associations in most states, and banking trade publications - to identify examples of innovative bank programs in the conservation area and to explore possible opportunities for additional innovation.
- Interviews with selected individual banks around the country with actual experience in conservation-related programs to discuss the results and lessons learned in those efforts; and contacts with banks considered likely candidates for embarking on such programs, to investigate their interest and ability to design and implement innovative program ideas.

- Contacts with federal and state government officials to identify programs and research relevant to this project.
- Discussions with other groups and individuals active in the energy conservation field, such as utilities, home improvement industry trade associations, and the like.

Working with the RERC project team in this effort was a group of selected officials from the First National Bank of Chicago (RERC's parent company), representing credit card operations, retail banking, bank marketing, and the corporate planning division.

2. WHAT ARE CONSUMERS SUPPOSED TO DO?

TO ACQUIRE A WIDE RANGE OF ITEMS WHICH CONSERVE ENERGY IN THE HOME, MOST COSTING FROM \$5 TO \$1,000, INDIVIDUALLY OR IN COMBINATION; SOME MOVEABLE, SOME BUILT-IN; SOME NEEDING TO BE PROFESSIONALLY INSTALLED, SOME DO-IT-YOURSELF.

Energy conservation policies in the residential sector have two basic objectives: to get people to save energy by behaving differently, and/or to acquire, install, and properly use devices or items which save energy within the home. Our project is concerned with the latter objective: the acquisition of conservation products and devices.

It was not the primary focus of our project to investigate the technical or economic features and performance characteristics of energy conserving products for the home, but it was necessary to familiarize ourselves with the available technology and its key characteristics. In conducting this part of our work, we developed several observations which raise significant issues for developing effective private and public sector conservation strategies, including considerations of the role to be played by commercial banks:

- There is a wide range of products and devices which offer conservation benefits to dwellers in all aspects of energy usage -- cooking, space heating and cooling, water heating, appliance usage, etc.
- Their costs vary widely, from \$.50 shower flow restrictors which conserve hot water to energy-efficient major equipment and systems costing several thousands of dollars.
- The majority of these items individually cost less than \$1,000 to acquire and install, and many fall under \$500.
- Many items cost more than their energy inefficient counterparts, posing a problem to consumers who are sensitive to first costs.

- The items differ in complexity. Some are easy to install, e.g., energy efficient appliances which can be plugged in. Others impose substantial inconvenience on the residents, e.g., attic insulation which may require accumulated possessions to be cleared from the attic, or installation of a new furnace or water heater which interrupts the flow of heat or water to occupants. And while some items are basically "do-it-yourself," others require experienced professional assistance.
- The cost-effectiveness of most of these items remains to be shown convincingly given uncertainties about product life expectancy, maintenance costs, future energy prices, and other key issues.
- There is no reliable, convenient, or comprehensive source of information about the costs, features and capabilities of these items, on which the consumer can depend to select and install the devices.
- There is no convenient "one-stop" shopping outlet from which consumers can investigate, select, and acquire a wide range of conservation items. Fire-place flue dampers are sold through one channel, clock thermostats through another, and pilot-light-less refrigerators and stoves through yet another.
- Thus far, most items have been marketed on a product-by-product basis through separate manufacturer/distributor channels. There have been few attempts to "package" multiple items to consumers, e.g., insulation plus storm windows plus clock thermostats.
- In competition with other objects of consumer investment (patios, vacations, education, cars, etc.), most of these items pale by comparison. They tend to be utilitarian in design, function, name, and appeal. They are usually described to consumers in ways which are highly technical and possibly unappealing or unintelligible.
- There is no established industry-wide certification or testing organization on which consumers can rely to compare the likely performance features of different products, or different examples within the same product line.
- While there are various trade and industry associations engaged in the manufacture, distribution, installation, and maintenance of particular product lines, no "umbrella" organization exists which conducts broad-based consumer education and advertising campaigns stressing "conservation" and its benefits as a concept, rather than individual products exclusively.

The issues mentioned above suggest potential difficulties for banks in developing conservation-oriented programs. The conservation marketplace and industry are largely primitive, especially when compared with products like automobiles which rely upon a well-developed industry infrastructure with sophisticated mass advertising and relatively well-informed, interested consumers.

3. WHY WOULD CONSUMERS WANT TO ACQUIRE CONSERVATION ITEMS?

MOST PROMOTION OF CONSERVATION HAS STRESSED SACRIFICE, PATRIOTISM, AND COST SAVINGS TO CONSUMERS. THERE ARE OTHER POWERFUL MOTIVATIONS -- FOR EXAMPLE, INCREASED COMFORT, OR THREATENED CURTAILMENT OF ENERGY SUPPLIES. IN CONTRAST, THERE ARE SIGNIFICANT BARRIERS TO CONSUMER ACCEPTANCE -- APATHY, INCONVENIENCE, SKEPTICISM AND IGNORANCE. CURRENTLY, CONSUMER DEMAND FOR ENERGY CONSERVATION HARDWARE IS LIMITED AND EPISODIC.

Thus far the primary messages used to promote energy conservation have been patriotism (saving energy helps the country become energy independent), sacrifice (tightening our energy belt to accommodate to shortages), or self-interest (saving energy saves money). For purposes of understanding why consumers would be interested in making conservation investments, the categories below suggest a wider range of motivations which might apply to specific groups of consumers:

<u>concern</u>	individuals who have a personal lifestyle that stresses frugality and who view conservation as <u>compatible with their values</u> regarding ecological responsibility.
<u>cost</u>	those who invest in conservation items in order to <u>save</u> on utility bills now or in the future, or who view conservation as a high-return investment opportunity.
<u>country</u>	persons who conserve energy because they believe it is in the national interest.
<u>comfort</u>	people who acquire conservation items (such as insulation or storm windows) to reduce drafts or improve the habitability of their dwellings.
<u>convenience</u>	those who include a conservation investment in some <u>other planned activity</u> , such as adding a room or reroofing.
<u>can't get</u>	individuals who are <u>forced</u> to conserve energy because of present or imminent curtailments due to climatic or geopolitical factors.
<u>confused</u>	those who are bewildered by the conflicting barrage of information regarding the existence and severity of the energy crisis, and what to do about it.

couldn't
care less

persons who are indifferent to conservation pleas.

contrary

people who are actually opposed to energy conservation, i.e., the unrepentant energy wastrel whose lifestyle equates energy waste with affluence and success.

Past experience indicates consumer interest in energy conservation tends to be highly episodic and short-lived, rather than sustained and continuous. On the whole, the marketplace has been indifferent to pleas for significant voluntary conservation, and remains to be convinced that failure of voluntary measures would require imposition of strict mandatory controls to compel energy conservation. Absent comprehensive, in-depth research, possible explanations for this consumer apathy must be largely speculative. The barriers to greater market penetration of conservation hardware could stem from several factors, among them the following:

skepticism

Consumer cynicism about the existence and severity of the energy shortage, the necessity for taking prompt and substantial conservation measures, the reliability of various hardware devices, and their ability to actually save significant amounts of energy.

indifference

While energy prices have risen at an unprecedented rate in many areas of the nation, the absolute amount paid for energy by many consumers is still small, compared to other items in their household budget. The prices of most of these items have been rising at least as rapidly (and in some cases more rapidly) than energy costs. This may change as energy prices and availability pose increasingly serious problems to consumers, but the impact of those factors will probably occur in a gradual or piecemeal fashion, as increasingly higher income groups cross the financial "threshold of pain" or as particular regions are hit with sporadic fuel shortages, e.g., the Mid-Atlantic states during the winter of 1976-77.

ignorance

Apparently many people either do not know what conservation steps are most effective (turning off unused lights versus turning down water heater temperature), or overestimate the costs of particularly effective measures (especially those of attic insulation).

inability to
afford items

Assuming consumers are interested and motivated to invest in conservation items, they must also be able to afford the costs of acquisition, installation, and maintenance of those measures.

lack of
available
attractive
financing

Consumers interested in conservation may have difficulty getting attractive financing for their purchases. For a typical middle-income family, many items may be too costly to be bought with cash, yet too small to be financed through a special single purpose loan. Credit card financing, the most convenient and accessible form, carries heavy interest costs to the consumer, who typically uses the card for relatively small purchases.

The primary purpose of considering these consumer factors is to indicate the complexity and variety of consumer motivations that underlie the level and nature of their demand for conservation products. They reflect both the realities and opportunities banks will face in developing independent or coordinated conservation programs. A sound understanding of the consumers' "conservation calculus" is essential in designing such programs.

4. HOW AND WHEN DO INTERESTED CONSUMERS ACQUIRE CONSERVATION ITEMS?

THEY BUY, RENT OR LEASE ITEMS BY USING CURRENT INCOME, PRIOR SAVINGS OR BORROWED FUNDS, OR THEY RECEIVE ITEMS AS GIFTS OR BY BARTER. THEY ACQUIRE SUCH ITEMS WHEN MAKING MAJOR APPLIANCE CHOICES, REMODELLING, OR CHANGING RESIDENCE.

An understanding of the consumer acquisition process is helpful in considering possible roles for banks in adapting it to conservation purposes. In terms of the acquisition of particular goods and services, there are six basic types of consumers*:

1. Cash Buyers: consumers who purchase items from current income, either in cash or by check.
2. Saver-Buyers: people who accumulate the necessary funds in advance of purchase, and then remove the money from savings at the time of purchase.
3. Borrower-Buyers: individuals who finance their acquisitions either partially or totally from funds loaned by third parties, including credit cards, personal loans, home improvement loans, mortgage loans, or other forms of credit.
4. Renters/Leasers: persons who pay to use items without owning them.
5. Donees: those who receive items by gift.
6. Barterers: individuals who acquire items in exchange for goods or services.

Most consumers fall into one or another of these categories, depending on the item being acquired and the characteristics of the person involved. The choice among these primary "modes of acquisition" apparently depends upon several factors: the cost of the item; the nature, extent, and duration of its anticipated use; its potential rise or decline in value; and his or her attitudes or values regarding debt, risk, and security, among others.

For purposes of this project, we are dealing primarily with the first three groups. Barterers have no connection with banks; donees are only peripherally involved with them (as recipients of premiums or give-away promotional items); and renting/leasing of conservation items through banks is largely infeasible due to the small dollar values and large administrative costs involved.

*Excluded are other types such as finders, thieves, etc.

Energy conservation items are acquired at three basic times:

1. When remodelling: when structural or cosmetic modifications are being made to the dwelling unit. Examples include adding a room, modernizing a kitchen or bathroom, or reroofing.
2. When changing residence: when the individual or household is moving into or out of a dwelling. Examples include buying a home, preparing an apartment for occupancy, and the like.
3. When making appliance choices: when appliances are first acquired, repaired, or replaced. Examples include the purchase of a new refrigerator, the repair of an existing water heater, or the replacement of an old furnace.

Each of these major acquisition times presents opportunities from an energy conservation viewpoint. They are situations in which the resident may be favorably disposed to acquiring conservation hardware items, e.g., buying an energy efficient appliance instead of a "BTU-guzzler" model, adding insulation while the house is being disrupted for remodelling, or making other major modifications before moving in.

5. WHAT DO BANKS DO, AND HOW ARE THEY INVOLVED IN CONSUMER ACQUISITION OF CONSERVATION ITEMS?

MOST BANKS OFFER A SIMILAR PRODUCT LINE -- DEPOSIT SERVICES (CHECKING AND SAVINGS ACCOUNTS), LENDING SERVICES (CREDIT CARDS AND LOANS), AND OTHER SERVICES TO INDIVIDUALS AND CORPORATIONS. HOWEVER, BANKS DIFFER WIDELY IN THEIR OPERATIONS, DEPENDING ON THEIR SIZE, LOCATION, AND OPERATING STYLE. BANKS ARE DIRECTLY OR INDIRECTLY INVOLVED IN ALMOST ALL CONSUMER TRANSACTIONS.

The World of Banking

There are many different types of financial institutions which might play a role in encouraging residential energy conservation. These include credit unions, savings and loan associations, finance companies, mutual savings banks, and commercial banks. Each offers its own range of financial products and services to consumers; each has its own style and tradition of operating; its own cost structure; and its own regulatory constraints within which it functions. Commercial banks remain the dominant class of financial institutions, both in terms of dollar volume and market coverage.

There are now approximately 14,500 banks in the United States, operating close to 44,000 separate offices. In contrast, there are more than 5,000 savings and loan associations operating roughly 14,000 offices throughout the country; 500 mutual savings banks in seventeen states; and 23,000 credit unions serving generally smaller customer groups. Thus, banks and credit unions provide the most convenient sources of consumer financial services in the nation, in terms of the accessibility of their offices.

Commercial banks are frequently referred to as the "department stores" of financial institutions. They offer a wide variety of financial services, from safety deposit boxes and trust management to complicated commercial financing packages. They are currently unrivalled in the scope of services they can provide, but prospective regulatory and statutory changes could significantly alter the competitive position of banks vis-a-vis other financial institutions in the consumer marketplace.

Banks hold a virtual monopoly over personal and corporate checking account business in the United States, under existing law. In addition, they hold close to half of all savings accounts, half of all consumer credit outstanding, and one-quarter of all residential mortgages. This indicates the potential impact of commercial banks as a force in financing energy conservation hardware acquisition. While the basic product line remains similar, banks differ markedly in how those functional areas are organized and managed, reflecting differences in bank size, setting, and style:

Size: The overwhelming majority of American banks are small-scale businesses. Roughly 90% employ an average of 34 employees; and half of all banks hold less than \$10 million in deposits each. On the other hand, eighty banks (.005%) retain about 40% of all bank deposits in the country. Moreover, 1,700 bank holding companies operate almost half of the nation's bank offices and control two-thirds of all bank deposits. Thus, banks vary widely in terms of the scale of their organization and the resulting complexity of their operations. Smaller banks tend to place greater emphasis on "retail" banking, i.e., providing services to individual customers. "Money center" banks, on the other hand, tend to concentrate on large volume commercial financing business.

Setting: A major factor influencing bank operations is the state regulatory environment in which they function. Banks located in states which allow statewide branching (the operation of multiple offices by a single bank organization) tend to place a heavy emphasis on "retail" and community banking in the localities in which those offices operate. Banks in states which prohibit or restrict branching, on the other hand, frequently lack the ability or incentive to develop strong personal customer bases in more than one location. An additional element of the setting is that of the competitive position in which a bank finds itself or to which it aspires. The incentive for the only bank in town to innovate may be minimal, compared with that of a bank struggling with other financial institutions to retain or increase its market share in a highly competitive arena. In the latter situation, banks are more likely to explore new strategies and service innovations in an effort to create a positive and differentiated market image with a profitable clientele. Finally, there is the less tangible element of tradition, which affects how banks approach new program areas like energy conservation. Certain markets or states tend to be more conventional in their banking practices, while others are more willing to experiment with new services or roles for commercial banks.

Style: Banks, like individuals, also differ in their innovativeness. Certain banks within each size category or market setting tend to be the early pioneers in particular areas of bank operations or marketing, e.g., adoption of bank credit cards, "personal banker" marketing image, everyday-language loan agreements, etc. Others tend to follow the path of these market leaders. Of course, the roles may change depending on the innovation involved, e.g., the first bank to offer drive-in service may have been a late entrant into consumer automobile leasing. But the pattern of the innovation process remains similar -- early pioneering by a handful of banks, dissemination of their initiatives through informal and formal industry channels, and later adoption of modified versions of those innovations by other banks.

The Product Line of Banking

The bread and butter business of banking is twofold: borrowing money from individuals and organizations in the form of demand and time deposits (almost 90% of total bank funds); and lending money to others (loan repayments provide two-thirds of bank revenues). The product line of the bank consists of five basic services -- direct lending, indirect lending, credit card accounts, checking accounts and savings accounts -- supported by marketing, promotion and public information programs. We have excluded the following services, which are only peripherally relevant to this project:

- Trust Services:- the management of living and testamentary trusts. This is offered by less than one-third of the nation's banks.
- Safety Deposit Boxes, Cashier's and Traveler's Checks, and Other Services.

1. Direct Lending

"Consumer credit" is the term generally used for short or medium term borrowing by individuals. It has grown phenomenally in the last 25 years, reversing the traditional pattern of "saving-to-buy" which dominated pre-World War II transactions. At the end of 1946, the dollar amount of outstanding consumer credit was \$4.1 billion; by 1975 it reached \$162 billion, an average of over \$2,000 per household. It has gone from an activity treated with some disdain and skepticism by banks, who tended to favor large and/or commercial borrowers, to become a major part of the banking business.

In the United States, 80% of such credit is in the form of installment lending. Consumer credit can be extended in two ways: direct lending and indirect lending. In the first case the bank provides funds to the individual in a one-to-one transaction. In indirect lending the bank makes funds available to the ultimate borrower through the medium of installment finance contracts offered by dealers or sellers. There are several types of installment and non-installment credit within the direct lending category:

"Closed End" Credit

- personal loans
- automobile loans
- home improvement loans
- other loans: education, debt consolidation, etc.
- mortgages*

*These are usually referred to as real estate loans, but for purposes of this project are considered a form of secured, long-term, closed-end consumer credit.

"Open End" or
Revolving Credit

- credit cards
- check credit
- check overdraft

This section will discuss "closed end" lending; later sections will review revolving credit.

The following table summarizes the overall importance of particular types of closed end credit, the market shares held by commercial banks, and the relative significance of each credit type to banks' loan portfolios:

Type of Credit	From the Market Perspective		From the Bank Perspective
	What % of total consumer credit does this type represent?	Of that amount, what % is held by commercial banks?	How much of total bank lending does that represent?
<u>Installment Loans</u>			
auto	6%	59%	14%
mobile home	1%	68%	4%
other consumer paper	4%	20%	3%
personal loans	5%	35%	7%
home improvement	1%	55%	2%
other	-	-	-
<u>Non-Installment</u>			
single payment	1%	89%	5%
charge accounts	1%	-	-
service credit	1%	-	-
<u>Mortgage Loans</u>			
1-4 family	48%	17%	36%
multi-family	10%	6%	3%
commercial	17%	31%	22%
farm	5%	13%	3%
TOTALS	100%	-	99%

Source: Federal Reserve Bulletin, 1975.

The table reveals that home improvement loans -- which should be an ideal vehicle for encouraging residential conservation improvements -- are only 1% of all outstanding consumer credit and, more significantly, represent only 2% of the banks' business.

The small amount of bank lending business that home improvement and personal loans represent probably reflects the higher costs of making small, medium-term loans to individuals. Such activities are not a high priority in terms of expanding or maintaining bank market shares, and not an area where a lot of money could justifiably be spent on marketing, or where incentives would dramatically expand the size of the market.

If banks are to look at energy conservation as a business opportunity, then clearly profitability is a key concern. The profitability of a loan depends on the following basic cost factors:

Cost of Funds

Cost to the bank for borrowed funds from various sources. Such costs vary, depending on economic conditions and competitive demand for funds by other financial institutions. A bank must take into account potential changes in those rates over the life of the loans it makes.

Acquisition/
Origination Costs

These costs derive from the functions of advertising and marketing, credit application, credit checking, loan committee review, and placing the loan on the bank's books, among others. These are essentially fixed costs, regardless of the size of the loan involved.

Servicing Costs

These include expenses such as those for processing repayments or handling delinquency and collection activities. They tend to vary according to the number of installments.

Closing Costs

These involve expenses incurred in closing the loan file, transferring title, notifying borrowers, and other filing tasks. These, too, are basically fixed costs like their origination counterparts.

Loan Losses

The expected losses due to delinquency and default on loan obligations.

In addition to these break-even costs, the bank must add its expected rate of profit or return. The combination of these factors, then, enables the bank to calculate the interest rate and term of maturity required for loans of given sizes in order to make the venture profitable. An example of this calculus can be shown using the data from the Functional Cost Analysis, compiled by the Federal Reserve Bank. The figure below illustrates the break-even points for three different loans, as computed based on the average costs of medium-size banks included in that study:

General Break-Even Points for Direct Installment
Loan Sizes at Various Rates and Terms
(291 banks with deposits \$50-200 million)

Source: 1975 Functional Cost Analysis, Federal Reserve Bank.

For example, on an average \$1,000 loan for 24 months, a bank would have to charge roughly 14.50% annual percentage rate merely to break even, before taking account of its desired margin of profit. The inter-relationships among loan size and bank costs, interest rate, and maturity make it virtually impossible, on a purely economic basis, for banks to offer customers dramatic reductions in rates for anything but larger loans. Minor changes in the loan package may be able to be justified on the basis of market entry, publicity or the bank's pro bono contribution to the community, but the possibilities for radical innovation in this area seem fairly limited, given the relatively low cost (mainly under \$500) of most conservation items.

2. Indirect Lending

In "indirect" lending, banks offer credit through retail merchants, or other intermediaries. The credit contracts are then purchased by the bank, which usually services the loan itself. The familiar example is automobile sales, where auto dealers offer bank financed loan packages to customers.

Indirect lending can, in theory, be a profitable source of installment loan business for banks. It can generate a large volume of loan business very rapidly. Since the dealer actually carries out many of the loan acquisition functions normally done by bank staff -- filling out credit applications, conducting customer interviews, arranging loan terms and placing title liens -- the bank can reduce its costs. In addition, indirect lending does not normally require any marketing or promotional activity by the bank, thus further reducing overall costs.

Indirect lending offers banks the potential for cross-selling,-- establishing bank relationships with dealers, and, to a lesser extent, with customers who usually end up paying their installments to the bank. The dealer benefits by making money selling his contracts to the bank, and by being able to close a deal quickly with convenient financing. Customers may benefit from having a "one stop" outlet for both purchase and financing, albeit at a frequently higher interest rate than if the financing were direct.

In reality, however, some of the benefits to a bank of indirect lending are less clear cut. Retailers would ideally like to extend bank credit to everyone, so their credit checking and application procedures may be considerably less stringent than the bank's. Since banks have no face-to-face contact with borrowers, the normal exercise of experience and judgment of the loan officer is absent. Bank relationships with dealers must be continuous to ensure the dealer an adequate supply of funds, but this frequently conflicts with more profitable uses for bank money.

In addition, there is the possibility of abuse and outright fraud on the part of retailers and dealers. These abuses end up as bank losses. Unscrupulous retailers who bilk or defraud customers bring the bank into disrepute in the customer's eyes, impairing bank/customer relationships. Banks can, and do, protect themselves against these problems by careful dealer/retailer screening, and continuous monitoring; some banks insist on doing credit checking and credit applications themselves. Obviously while these safeguards reduce problems, they also increase costs and trim the margin of profitability.

Despite these problems there are potential areas within the indirect lending category that could benefit energy conservation objectives. Banks could link up with other parties who have a greater "vested interest" in conservation than banks, e.g., utility companies, retailers and distributors of energy conservation hardware, and home improvement contractors. By pooling talent, resources and money, a more effective marketing strategy could emerge.

Each of these possible relationships involves a coordinated approach to potential consumers of energy conservation items. Ideally, such strategies should build upon the unique strengths and weaknesses of each party. For example, utilities offer excellent access to residential energy consumers through sophisticated, comprehensive billing and service mechanisms. However, they are usually inexperienced or ill-suited to provide small amounts of credit for non-fuel purchases. Home improvement contractors may suffer from market image problems that limit their credibility. Nonetheless, they have obvious advantages in terms of installation or maintenance of energy conservation devices. Retailers -- hardware, building supply, and other consumer outlets for energy conservation products -- provide convenient coverage of the do-it-yourself market, but are often ill-equipped to handle individualized credit transactions involving closed end loans for their customers. This enables banks to perform the role in which they are most familiar and comfortable, i.e., the provision of financing to businesses and individuals - leaving functions like hardware promotion, selection, and installation to other, better equipped parties.

3. Credit Card Accounts

The use of credit cards has mushroomed in the United States in the last ten years, resulting in changes in both the retail and banking industries. In 1970, consumers charged more than \$7 billion of purchases on credit cards; in 1975, the figure rose to \$20 billion. The average bank card purchase is \$24, and the average outstanding balance is under \$300.

At the present time, roughly 68 million Americans carry bank credit cards, including over 70% of people earning over \$10,000 per year. Bank credit cards are accepted at more than two million retail businesses. Nearly all of the nation's 14,500 banks are involved in credit card operations, with over 7,000 offering Mastercharge, and nearly 7,000 providing BankAmericard in 1975.

Credit cards have become so pervasive that it is easy to forget that they are a relatively recent innovation with a particularly turbulent record as far as bank sponsorship is concerned. Banks have lost much money on credit cards in the past, especially during the developmental period of 1955 to 1965, and many banks continue to do so today. At best credit cards are not a "windfall" profit-maker; and miscalculations have often led to serious losses. For instance, the "free 30 day loan" feature is proving difficult for banks to eliminate, yet many card promotional mailings have focused on the middle and upper income individuals most likely to use that feature. The Federal Reserve profile for high earning banks shows that credit card strategy is often "least loss" oriented rather than "most gain."

Dollar Volume of Credit Card Credit Outstanding (in 000's of dollars)

	Under \$100	\$100-500	\$500-1,000	\$1,000-5,000	\$5,000-10,000
Loss Per Active Account	(\$.45)	(\$1.55)	(\$3.19)	(\$3.89)	(\$4.68)

Source: Federal Reserve Bank, Performance Characteristics of High Earning Banks: Functional Cost Analysis.

Credit cards, for all their volume, account for less than 2% of earnings for large banks; less than 1% for medium-sized banks; and are a net loser for small banks. The reasons why banks continue to offer credit cards are the less tangible opportunities to reduce the use of checks (a costly and cumbersome form of transaction), improve the conditions for the introduction of electronic funds transfer, widen banking relationships with bank customers (cross-selling), and increase business with participating retailers.

Credit cards are paradoxical from an energy conservation perspective. Their great convenience and flexibility makes them a likely means of financing small-scale conservation product purchases. Yet the operating costs and constraints associated with the mass credit card business make difficult any modifications of interest rate, amounts or terms of credit card loans. The highly routinized operations make it difficult and costly to "customize" credit cards for energy conservation purposes. In addition, the maze of regulations in this area (Regulation Z, Truth-In-Lending, fair credit reporting, usury statutes, etc.) exacerbate the problems faced by a bank seeking to modify its credit card package for only a particular market segment.

Interest rates are currently at the legal limit. Terms are already very flexible. Increasing credit limits yields little improvement since credit card holders do not now use their full credit ceilings. Special purpose raising of credit limits for energy conservation purchases for a limited time might attract some consumers (especially if tied in with participating retailer promotions), but would cause administrative problems (verification, special billing, etc.) that could be quite costly to the bank. Thus, the main opportunity for encouraging conservation lies in using credit card statements and retail outlets as promotional vehicles.

4. Checking Accounts (Demand Deposits)

At present, approximately nine out of every ten financial transactions in the United States involve the use of checking accounts, roughly 26 billion transactions annually. While the majority of checking accounts are well under \$500, less than 6% of all accounts represent nearly 60% of the total demand deposit funds. This suggests the importance of wealthy individuals and corporations to this segment of bank operations.

The value to a bank of acquiring a demand deposit account is hard to determine, since the yield is affected by the average balance and the account activity, i.e., the frequency with which deposits are made and checks written. The Functional Cost Analysis of the Federal Reserve Bank indicates that the overall break-even point for checking accounts is between \$1,200-\$1,800 average balance per account.* Most personal accounts have balances below that level yet despite the marginal profitability of such accounts, bankers value the checking account as the cornerstone of their customer relationships.

*Data are based on average costs. The profitability of any individual checking account would depend on incremental costs to the bank.

While direct lending opportunities for innovation in demand deposit accounts are currently somewhat limited, changes in the competitive environment for this service may force commercial banks to seek new advantages if they are to preserve a major portion of a market in which they now have a monopoly. The emergence of the NOW account (negotiated order of withdrawal), and current proposals to allow credit unions to provide checking accounts, are harbingers of changes with potentially major consequences in this area of banking.

5. Savings Accounts

Savings and time deposits in commercial banks have quadrupled in the last 15 years, and now exceed demand deposits. This is largely because of changes in the restrictions on permissible interest rates, especially on large amounts held for longer maturities. These changes have allowed commercial banks to compete for these deposits more effectively with savings and loan associations and mutual savings banks. In 1975, commercial banks held almost \$459 billion in savings accounts, representing half of the nation's savings. Roughly three-quarters of American households have some form of savings account, with higher percentages in the higher income groups.

There are four basic types of savings and time deposit accounts: regular passbook accounts, - (these are the most common form of account), club account, certificates of deposit, and others, including bank savings bonds and special-notice time open accounts.

Like their checking counterparts, the profitability of time and savings deposits is dependent on the size of the account and its level of activity (number and frequency of deposits, withdrawals, and other transactions). While profitability of such accounts is moderate when viewed in isolation, their importance to the bank goes beyond the direct earnings they generate. Their role as sources of funds -- individual depositors borrow back only one-fourth of their deposits -- and as the basis for extended customer relationships make these services vital to bank operations.

In view of the tightly regulated nature of time and savings accounts, the opportunities for encouraging energy conservation through bank innovations in these services lies in special marketing of existing services.

6. Support Services: Marketing, Promotion and Public Information

Banks do two basic kinds of marketing and promotion. First, they promote the image of the bank through corporate, umbrella advertising -- stressing the bank as "friendly," "responsive," "convenient," "secure," or "trustworthy." There is considerable evidence that bank customers are not comparison shoppers for many of the services banks have to offer. Thus, name recognition and a positive market image (as well as building on existing relationships) is important to banks. This kind of activity represents roughly one-quarter of bank marketing expenditures.

Second, banks also promote specific customer services, such as "free" checking accounts, "high-interest" savings accounts, safe deposit boxes and the like. These are the banks' "product line." From time to time a bank may focus on particular goods or services for which their product line is especially useful -- a vacation, a patio, or a new car -- but these messages are intended more as examples of the convenience and versatility of bank services in satisfying consumer needs or desires, rather than explicit promotions or endorsements of vacations or cars per se. This second type of activity accounts for three-quarters of bank promotional spending.

Marketing activities of commercial banks have grown rapidly in both dollar volume and sophistication since the 1950's. Commercial banks spend several hundred million dollars each year to promote bank services, the character and qualities of individual banks, and the role of the banking industry in society. Active marketing is a relatively new concept in American banking. As recently as 1966, an American Bankers Association study showed that 75% of banks had no designated personnel with marketing responsibilities. And aggressive marketing is still regarded with considerable ambivalence within the industry.

Banks recognize the multiplicity of reasons for borrowing money or using bank services and the wide diversity in lifestyle and values of their customers. For these reasons they tend to adopt a "value-free" approach to lending. They are quite reluctant to use their marketing and promotion budget in areas where demand for a specific product is neither clear nor compelling. Banks avoid endorsing specific products or services other than their own. Few, if any banks, would encourage a customer to vacation in Hawaii rather than Europe, or buy a Chevrolet rather than a Ford. Even less likely is for banks to suggest that consumers are making unwise investments of the money they borrow -- that they should insulate their house rather than go to Hawaii. In short, banks find it in their interest to care very little why the customer borrows money, as long as he or she repays it according to the agreed terms.

Even if conservation were given a high priority by banks, the amount of marketing resources that could be devoted to it would be relatively small, given competing demands for those funds by other segments of the bank's business. Bank marketing budgets are often more limited than those of other businesses of comparable size, and must be spread across more than a dozen different services.

Exacerbating these constraints is the fact that new program promotions usually demand extensive advertising and publicity in order to achieve even limited market awareness and response. Energy conservation is no exception. Being first to enter a market area can be rewarding. It can generate free, favorable publicity because of the program's newsworthiness and connection with a timely topic of public concern. Such benefits are likely to dissipate as more banks enter the area, although the late-comers could profit from the cumulative effect of prior publicity given to earlier programs by competitors.

In view of the limited opportunities to encourage conservation through dramatic innovations in the banks' primary product line, the use of sophisticated, aggressive marketing techniques becomes critical. In fact, those banks that have developed successful conservation-related programs have devoted considerable attention to effective public promotion.

Banks' Involvement in Consumer Acquisition of Conservation Items

Banks are involved in almost all consumer transactions, either directly or indirectly. The acquisition of conservation products is no exception. The particular bank service or department involved depends upon how and when the consumer chooses to acquire the item, as illustrated in the chart on the following page.

THESE BANK DEPARTMENTS OR SERVICES ARE INVOLVED

FOR INDIVIDUALS WHO ACQUIRE ITEMS

also referred to as "demand deposits" since the depositor can draw upon deposited funds at will by writing a check.

CHECKING

by personal or cashier's check

also referred to as "time deposits", including regular passbook savings accounts, term or notice deposit accounts, certificates of deposit, and savers club accounts.

SAVINGS

in cash or by check, using prior savings

banks frequently provide revolving credit by both check overdraft ("no bounce") plans and bank credit cards (Mastercharge and BankAmericard) to customers in the form of a pre-established line of credit which consumers can utilize at will up to the credit ceiling.

"OPEN END"
CREDIT

using check overdraft or cash reserve feature of their checking account or by using a bank credit card either as a short-term interest free loan or as an extension of revolving credit

this includes lending funds to individuals, organizations, and businesses without working through a third party. In the case of loans to individuals, this activity involves personal loans, home improvement loans, mortgage loans, education loans, automobile loans, and others.

DIRECT LENDING

with borrowed funds through a: personal loan, secured or unsecured; home improvement loan (when remodeling); mortgage loan (when buying or refinancing a residence)

the provision of consumer financing through third parties, usually retail outlets, e.g., automobile dealers. Usually, the dealer arranges the loan application, the bank does the credit checking and loan approval, and then buys the loan contract (called "third party paper") from the dealer and services the loan account itself.

INDIRECT CONSUMER
LENDING

by financing the purchase or lease through a dealer or retailer

supporting all bank services are advertising, public relations, market research, and marketing activities, which are responsible for promoting the bank's product line.

by gift as part of a bank premium or give-away promotion campaign

by using any or all of the above services

In the following sections of this report we will examine ways in which banks could play a more positive role in each of these areas to encourage energy conservation by homeowners and apartment dwellers. But first one must understand the possible reasons why a commercial bank might be interested in promoting conservation among its customers. The strengths and appeal of those motivations will go far in determining the level and duration of bank commitment to whatever conservation activities it embarks upon.

6. WHY WOULD BANKS BE INTERESTED IN PROMOTING ENERGY CONSERVATION?

BANKS MIGHT DEVELOP ENERGY CONSERVATION PROGRAMS AS A BONA FIDE BUSINESS OPPORTUNITY; A WAY TO REDUCE ENERGY-RELATED LOAN LOSSES; A LOSS LEADER FOR OTHER SERVICES; A PUBLIC RELATIONS GESTURE; OR TO FORESTALL INCREASED GOVERNMENT INVOLVEMENT IN BANK OPERATIONS,

In discussions with bankers and government officials during this project, several possible motivations were suggested regarding banks' interest in residential energy conservation generally, and program innovations specifically:

1. Promoting energy conservation as a new market or bona fide business opportunity - Some see energy conservation as an emerging new market area. As energy prices and shortages continue to increase and the regulatory environment becomes more strict, consumers are more likely to invest in conservation hardware. To the extent that consumers will require financing to acquire such items, banks stand to gain a new source of both open and closed end lending business. Of all possible motivations for bank involvement in conservation programs, this is the most powerful in terms of ensuring a sustained high level of interest and support from a broad spectrum of banks.
2. Stressing energy conservation investments as a means of reducing the bank's loan losses from defaults and delinquencies indirectly stemming from borrowers' difficulties in meeting rising energy costs - There has been a fair amount of anecdotal evidence which suggests that skyrocketing fuel prices have jeopardized borrowers' ability to meet their monthly mortgage or other loan commitments in some regions. The actual extent of this phenomenon remains unknown, although ongoing research by FEA should shed some light on this issue. For the present, bankers contacted in this study were not very concerned about this factor, but several recognized it as a potential problem in the future. They point to the experience of many utility companies who are encountering increasing difficulties with delinquent accounts as a result of recent fuel price hikes.

3. Using energy conservation programs as a "loss leader" to attract other profitable business - This rationale suggests that offering favorable conservation-related programs or services which are marginally profitable on their own merit may nonetheless open the door to other, more financially attractive customer business. For example, absorbing small losses on special conservation promotions of discounted home improvement loans may be worthwhile if sufficient deposit relationships can be attracted with compensating account balances. Loan volume could be increased by offering special conservation-rewarding features on home mortgages. The persuasive appeal of this argument depends on the likelihood that such "cross-marketing" would result from identifying the bank with conservation activities.
4. Supporting conservation programs as evidence of the bank's corporate social responsibility or as a public relations gesture - Most bankers contacted considered energy conservation a laudable objective with which banks would like to be aligned. Some saw benefits from a public relations point of view in encouraging conservation investments by homeowners and renters. But given the questionable level of consumer demand for such items presently, banks might be unwilling to provide significant or sustained support to such a campaign.
5. Developing energy conservation programs as a means of forestalling possible government regulation - Most bankers oppose increased governmental regulation or intervention in their lending portfolio decisions. Should energy conservation become a dominant public issue, and lack of suitable financing emerge as a major political concern, some bankers foresaw the prospect that government might begin requiring banks to participate in conservation activities, e.g., by setting aside a designated portion of funds for conservation projects, incorporating conservation considerations into all mortgage and home improvement lending decisions, and the like. In order to avoid being forced to adapt bank practices to programs and priorities of outside parties, some banks might view voluntary development of conservation programs as the better alternative.

Based upon our contacts with bankers and banking industry representatives, none of these motivations are particularly strong at present. Recent events such as the winter freeze in the Mid-Atlantic states and President Carter's announced emphasis on energy conservation have increased the level of awareness and interest among banks to develop conservation programs. However, major bank commitments to this area will probably await the day when large numbers of consumers begin clamoring for conservation devices and related financing, thus legitimizing conservation as a full-fledged business opportunity for banks rather than an object of passive, inconsistent, or token attention.

Having reviewed the possible reasons why banks might become involved in conservation programs, let us examine what banks have actually done in this area.

7. WHAT HAVE BANKS DONE SO FAR TO ENCOURAGE CONSERVATION?

VERY LITTLE. ONLY A FEW BANKS HAVE DEVELOPED SPECIFIC PROGRAMS TO ENCOURAGE RESIDENTIAL ENERGY CONSERVATION AND MOST OF THOSE HAVE ENJOYED ONLY LIMITED SUCCESS.

Theoretically, banks could play an innovative role in each of the customer relationships it has with potential energy conservers: as checking account clients, savings depositors, direct borrowers, or as potential customers. Yet for various reasons, banks have largely ignored the field of residential energy conservation. The overwhelming majority of banks have done nothing to encourage conservation with their customers. On the other hand, they have done little to discourage it either. Energy conservation is essentially a non-issue in commercial banking, at least at the present time; this despite the governmental concern with conservation as a vital element of this nation's energy policy.

The First Cycle

During the past several years, only a handful of banks around the country have experimented with programs designed to encourage energy conservation. Many of these efforts came during the time of the first Arab oil embargo and gas crisis of 1973. Few involved reduced loan rates, extended terms, premiums, or the like. Most were simply one-time or short-lived special energy-focused promotions of the bank's normal product line. Only one or two were offered in cooperation with other parties such as manufacturers, retailers, installers, utilities, or others.

A capsule description of these early bank conservation programs follows:

The First Cycle - Selected Program Examples

Bankers Trust Company
New York, New York

In early 1974, the bank promoted "The Anti-Freeze Loan" for energy-conserving improvements such as storm windows, insulation, and furnace overhaul. The program, promoted through several newspaper and magazine advertisements, offered no interest rate reduction or special features. Technically, the program is still in operation.

Fidelity Bank
Philadelphia, Pennsylvania

In late 1973, the bank ran a series of newspaper advertisements offering "Fidelity Energy Loans" at 11.35%; under the terms of the program, consumers could borrow up to \$5,000, defer the first payment for 45 days, and take up to 60 months to repay the loan. The program was terminated after six months due to the absence of consumer interest.

First National City Bank
New York, New York

"The Housewarming Loan" was promoted through newspaper advertisements in December of 1973. The program, a special promotion of the bank's home improvement lending program, offered no preferential rate or terms. No consumer response to the promotion was identifiable, and the program was terminated.

Irving Trust Company
New York, New York

In November of 1973, the bank reduced the interest rate on energy-saving home improvement loans by 1.99%. The first payment could be deferred up to 60 days, with extended terms up to 10 years. Despite promotion through newspaper and other media, the program generated almost no consumer response and was terminated several years ago.

Northwestern Bank of
Great Falls
Great Falls, North Dakota

A special promotion of the bank's normal home improvement program, oriented toward energy savings, was carried out in 1974. The promotion, "Dollars and Sense" offered no special features or terms. Weekly newspaper advertisements in a question and answer format offered suggestions on how to reduce energy consumption. The program has since been terminated.

Provident National Bank
Philadelphia, Pennsylvania

In December of 1973, the bank reduced auto loan rates for cars with a minimum EPA rating of 15 mpg by 5%, and rates for energy conserving home improvement loans by 2%. The program was cancelled almost immediately, due to opposition from automobile dealers with whom the bank conducted substantial indirect lending business.

Shenandoah National Bank
Winchester, Virginia

The bank promoted energy conservation loans in April of 1974 as part of its normal home improvement loan program. No special discounts on interest rates, deferred first payments, or extended terms were offered. Consumer response to the newspaper and radio ads was minimal, and the special promotion was terminated in the late spring of 1974.

The National Bank of
Detroit
Detroit, Michigan

Several advertisements offering a 1/2% discount on fuel-saving home improvement loans up to \$4,000 were run by the bank in February of 1974. Eligible items included insulation, efficient furnaces, storm doors and windows, new roofing, insulated siding, weatherstripping and caulking, double-glazed windows, and automatic garage door openers to cut heat loss. The program generated very little consumer response and is now operationally defunct.

Vermont National Bank
Barrington, Vermont

In early 1974, the bank promoted the five-year term "Warm-Up-Your-Home Loan," offering energy conserving home improvement loans at a 1 1/2% interest rate reduction from the normal home improvement loan rate. Consumers did not take advantage of the program, and the latter was discontinued.

Winters National Bank
Dayton, Ohio

From August of 1974 through April of 1975, the bank promoted "Winterizer Loans" at a 1 1/2% discount off the normal home improvement loan rate. Qualifying energy conservation measures included insulation, storm doors and windows, and furnace improvements. Dayton Power and Light Company verified the reputations of contractors selected by the bank's customers. Consumer resistance to the program was felt to be high; and the program is effectively defunct.

Consumer response to this "first cycle" of bank conservation programs was non-existent at worst and marginal at best, a result colorfully described in the words of the bankers involved:

"It's been an unmitigated disaster since we announced our program -- we haven't had one customer show his face at our home improvement desk."

"To say the least, it did not have a significant impact in the marketplace. It was definitely not a world beater."

"Banks should not try single-handedly to swim upstream against resistant consumers."

"Banks are willing to accommodate consumer demand, but are not in the business of creating it."

"We don't care what they borrow money for, as long as they pay us back. To ask additional questions such as how much insulation the borrower has, what kind of car he drives, how large his heating bill is, and the like, not only creates too much paperwork in an already costly process, but runs the risk of creating an image of officious meddling into private affairs."

"We have 26 banks virulently competing in our area. If energy conservation was a big deal some of these banks would have picked it up and would be working it to death."

"It was our ad agency that came up with this idea; they're really novices."

"Nobody broke down our doors. Very, very little happened...It was a great disappointment to us. We felt it was a very timely topic with good, specific ads, but it produced no results."

"Interest rate reductions don't sell anything."

"Our experience in things like education loans should have told us that interest reductions wouldn't generate much new business."

"If it's under \$500, it probably goes on the credit card anyway."

"I'll believe energy conservation is a big idea when consumers are climbing on my desk for loans."

The Seattle Trust and Savings Program

In July of 1976, the Seattle Trust and Savings Bank announced a new energy conservation lending program offering reduced interest rates for qualifying borrowers. Both in terms of its comprehensiveness and the quality of its technical supporting materials, this program is by far the most sophisticated, well-designed conservation effort yet mounted by a bank. It has received substantial publicity, including articles in the Wall Street Journal, bank trade publications, and even mention in the first presidential campaign debate.

The program was designed by a team of independent energy consultants working with bank personnel and advertising professionals. Four types of loans were offered: home mortgage, home improvement, automobile, and boat. In order to qualify for the reduced rate, the borrower had to satisfy certain energy conservation criteria, such as buying a car with an EPA highway rating of at least 25 miles per gallon, or a boat with an energy efficient propulsion system.

In the residential lending categories, a convenient point system was designed which gave certain values to a list of specified conservation measures or devices. For example, R-19 ceiling insulation was rated at 5 points, storm windows at 3, while an energy efficient home appliance received only 1 point. A minimum of 15 or 25 points was required to qualify for an 8 1/2% 30-year mortgage for up to 80% of the home's appraised valuation. In the case of a newly-constructed home or an older home valued at \$75,000 or over, many of the conservation improvements were required, regardless of point value. To qualify for home improvement loans of 8 3/4% for up to 10 years, the borrower had to agree to use a substantial portion of the amount borrowed for conservation measures to meet similar point standards for older homes. Both residential loans were offered only to owner-occupiers.

Physical certification of the energy conservation features of dwellings was handled by a team of "Energy Conservation Loan Inspectors" who inspected each home to ensure its compliance with the terms of the lending agreement. The inspectors are local college students trained by the local utility and employed on an as-needed basis, and paid on a piece-rate basis. Costs of inspection are roughly \$20. The actual costs of program design, promotion, inspection, and administration have not been calculated by the bank.

The motivation for embarking on this program stemmed from Seattle Trust's involvement in a local neighborhood revitalization effort in an inner city area. The Bank felt that favorable terms on residential lending would encourage homeowners to make desirable home improvements and at the same time reduce energy usage. In addition, the planners of the program thought an innovative campaign could stimulate loan volume and consumer interest, in addition to enhancing the Bank's market image.

The results thus far have been gratifying. Mortgage lending activity and volume have increased significantly. Bank officials attribute this success to the borrowers' recognition of the amount of savings represented by a 1/2 or 3/4% reduction in interest rate on such a long term loan, as compared to a comparable discount on shorter term notes. Many customers seemed willing to shop around among potential mortgage lenders for the best rates. Boat and auto loan volume also increased, but the former area was already a major market for the bank locally and the latter remains a relatively small business in dollar terms. The biggest disappointment was the low response to the cut-rate home improvement loan promotion. While no formal evaluation effort has been undertaken, one bank official connected with the program suggested this might be due to the relatively limited appeal of interest rate reductions on this type of discretionary loan. Mortgage loans usually are a necessity for most homebuyers; home improvement loans are not.

Thus, the bank considers the program a success, both from the standpoint of generating valuable new loan business and stimulating widespread free favorable publicity. Since all four loan categories also had a cross-marketing feature (whereby borrowers had to open a Seattle Trust checking account as part of the qualifying for the loan), the bank was also able to generate new depositor relationships in addition to its increased lending business.

While the Seattle program is promising as an example of what can be done by banks to promote energy conservation, it is too early to conclude that comparable efforts would be profitable and successful for all banks. There is some reason to believe that the primary benefits accrue to the first bank in a particular market area that launches such a well-marketed program. Once other competing banks offer duplicate loan incentives, the sponsoring bank stands to lose at least the distinction and free publicity associated with being an innovator with a novel and timely idea.

Furthermore, while the Seattle program is worthy of replication in other market settings nationally, its basic design could be modified and improved. First, a more integrated approach to program promotion could be tested, in which the sponsoring bank would join forces with local utilities, conservation product distributors and installers, and other relevant actors in marketing and administering a comprehensive community-wide program. The Seattle program had limited informal links with the local municipally-owned utility, but no special ties were created with insulation contractors, home improvement outlets, and the like to develop a coordinated, overlapping marketing strategy.

The second possible modification worthy of testing elsewhere is a greater reduction in interest rates than was offered by Seattle Trust, especially on home improvement loans. Absent outside subsidy, many banks will likely be unwilling to offer much greater reductions in the interest rates on mortgages. In fact, banks frequently complain about the inadequacy of normal fixed rates on such loans in an era of continuous inflation. But in home improvement lending, a bank interested in promoting conservation might be willing to accept a thinner margin of profit if that would trigger sufficient loan volume in return. The amount of any such reductions will vary over time as the cost of funds to the lenders changes, and other lending areas become more or less attractive relative to the home improvement business.

A copy of the bank's own description of its program, including a sample of the checklist of conservation measures, follows.

This material is an exact reproduction of documents provided by the Seattle Trust and Savings Bank, Seattle, Washington. While there is some duplication in the four separate elements, it has been reproduced here in its entirety since it gives an excellent overview of the growth and development of the program.

We thank Seattle Trust for its permission to use this material.

Seattle Trust
SEATTLE TRUST & SAVINGS BANK EST. 1905
804 SECOND AVENUE
SEATTLE, WASHINGTON 98104

NEWS RELEASE FOR JULY 6, 1976

For further information please refer to Marketing Department 223-2101

SEATTLE TRUST TIES HOUSING REHABILITATION LOANS
TO ENERGY CONSERVATION STANDARDS

Seattle Trust & Savings Bank announced today a new consumer loan program designed to promote energy conservation in home ownership, home rehabilitation, automobile usage, and recreation.

The bank is offering loans at advantageous rates and terms if the bank customer takes positive steps to adopt sound energy conservation and efficiency standards set forth by the Federal Energy Administration, the Environmental Protection Agency, state and local governments, and many utilities and professional associations.

Qualifying customers will receive up to 30-year home ownership (mortgage) loans at 8-1/2%, 10-year home rehabilitation loans at 8-3/4%, 4-year automobile loans at 8-3/4%, and 10-year boat loans at 8-3/4%.

The program will be available to bank customers everywhere, and will be of particular benefit to older homes, especially those in inner-city

neighborhoods. Last week Seattle Trust was announced as contractor for the administration of the Seattle Stevens Neighborhood Rehabilitation Program, by which the residents will bring their homes up to contemporary health, safety, and habitability standards over a five-year period. The new loan program adds incentive for owners to include improvements which will also make their homes as energy efficient as possible, and thus more economical to operate. The program is also intended to encourage new residential construction on available sites in older districts.

To qualify for an 8-1/2%, 30-year, home ownership loan, a bank customer would have to provide at least a 20% down payment on the appraised property valuation and see that the house meets at least 15 points of the bank's energy conservation criteria. These include insulation of the outer shell, heating system and appliance efficiency, and other innovative conservation strategies such as heat pumps and solar energy. New and more expensive homes would need more conservation points to qualify than older homes, although all homes would need to employ substantial conservation strategies to meet the criteria.

The qualifying criteria for a home rehabilitation or improvement loan, which may have a term of 10 years at a rate of 8-3/4%, provides that a substantial portion of the loan be used to retrofit or improve the

house to meet these same standards, not all of which would have to be accomplished at once.

A rehabilitation loan may be used in conjunction with a home ownership loan. The bank will both lend to home owners purchasing on contract, and will permit home owners to perform their own work. The loan program is available only to owner (or purchaser) occupants. Home ownership loans will be made to refinance existing loans or contracts if the loan also provides for substantial new renovation and improvements.

No minimum or maximum loan amounts are specified. These will be determined by the customer's actual requirements, credit worthiness, and the appraised valuation of the property. Part of the bank's program will be to take extra efforts to assist borrowers to qualify for and to manage the credit needed to do the job. Appraisal standards will give full value to a home property as it stands after it has been improved and has become as energy efficient as possible.

Bank customers will be able to obtain detailed written material by energy conservation officials on how to prepare homes to meet the bank's standards, most of which can be readily and inexpensively met. The area's major energy suppliers also have field consultants who will advise at little or no cost to the consumer. Private consultants may also be retained by customers to establish a specific energy efficiency program acceptable for bank financing.

Auto loan customers will receive an 8-3/4% rate of interest for four years on new automobiles that are EPA rated to obtain 25 miles or more per gallon of gasoline on the highway. The bank noted that 240 models of the 1976 cars qualify under this criteria.

Boat owners will also receive the benefit of lower rates if their boat's main propulsion plant is energy efficient. This would include most sail craft, and also power boats whose engine and hull characteristics provide the best relative energy consumption potential. In this latter category would be full displacement hulls, semi-displacement hulls if diesel powered, and small outboards under 25 hp. Boat loans were specifically included for special credit consideration because of the bank's long commitment to safe and energy efficient recreation as an important adjunct to Northwest living.

The bank has every expectation that these basic strategies for consumer energy conservation will be amplified by customer suggestions and new technology. It is hoped that the program will evolve over time to include other accredited means of energy economy.

Interest rate schedules for new loans will be subject to changes that may occur in the bank's cost of deposits from customers. Once a loan has been made, however, the rate will not be changed as long as the basic conditions for the loan remain in effect.

Underlying the entire program is the bank's desire to help consumers recognize and take advantage of more energy efficient and economical means of household living, of transportation and recreation; energy consumption is obviously going to become a critical consideration in all these activities, to say nothing of the cost of energy's impact on the monetary value of real and personal property.

The bank's program also reflects its traditional role of encouraging thrift, and notes that historically its most successful customers have been very aware of the importance of both personal financial thrift and conservation of property and resources. The bank officers feel that the desirable economic and social purposes served in home rehabilitation and maintenance of the community's older housing stock is directly connected with the ability of people to live in such properties in the most efficient and economical manner. Thus, there is a natural relationship between resource conservation and sound economic practices by both the bank and its customers.

Independent professional consultants have been involved in formulating the bank's initial program and will continue to follow its development. Among them is Wilson Clark, author of *Energy for Survival* (Doubleday, 1975), who states,

"The criteria for this program have been established to effect the maximum possible conservation savings in new

and older homes at low cost. For example, in an older home which is heated with natural gas, the conservation rehabilitation program could reduce fuel needs by 40-60 percent yearly. At today's fuel rates, this increase in the home's energy efficiency would effect economic savings which would be paid back in 4 years or less.

The primary conservation measures include retrofitting of R-19 (6") insulation in the ceiling, upgrading furnace efficiency to 75 percent, and retrofitting wall and floor insulation, where applicable."

#

ENERGY CONSERVATION LOAN QUALIFICATIONS

Single Family Detached Residences

For an Energy Conservation Loan, the home must qualify for the minimum required number of points on The Energy Conservation Loan Checklist. The requirement is based upon the current market value of the home and whether the house is new or used. All homes must be owner occupied.

- A. Existing Homes Valued Below \$75,000 must qualify for at least twenty points of energy conservation features already existing in the home, or to be installed, including five points for "required" ceiling insulation.
- B. Existing Homes Valued at \$75,000 or Above And All New Homes must qualify for at least twenty-five points, including those features listed as "required". A "new" home is one where construction began on July 15, 1976 or later, and the applicant will be the first occupant. A retrofit to a heat pump is not required in existing homes, but the five points required must be substituted by five points from elsewhere on the Checklist.
- C. All Home Improvement Projects must result in the home qualifying for at least twenty points, including points for planned improvements. If the home does not reach twenty points, then a minimum of 30% of the amount of the loan must be expended for energy conservation related items.
- D. Refinancing of a home by current owner occupant to an Energy Conservation Loan, requires that money be available from the refinancing to apply to a substantial new energy conservation project, regardless of how efficient the house is presently. At least twenty-five points are required to qualify.

Please note in the "Describe What You Have" column when items are not yet installed, but will be.

Name for Entry
Instruction: _____**Seattle Trust**
SEATTLE TRUST & SAVINGS BANK EST 1908**ENERGY CONSERVATION
LOAN CHECKLIST**

Property Address: _____

Telephone: _____

Please Check (✓) Items That Apply and Total the Points	Points	Describe What You Have	Existing Home Below \$75,000	Existing Home \$75,000 & up - All New Homes
HOUSE SHELL INSULATION				
1. Ceiling Insulation (R-19)	5		Required	Required
2. Wall Insulation (R-11)	5			Required
3. Floor Insulation (R-11) (Over Unheated Areas)	5			Required
4. Storm Windows or Double Glazing	5			Required
5. Plastic Sheeting Over Windows	1			
6. Storm Doors	2			
7. Basement Foundation Insulation (R-11)	3			
8. Window and Door Weatherstripping	2			Required
HEATING SYSTEM				
9. Furnace Efficiency - 75% or Higher (Gas and Oil Only)*	5			Required
10. Heat Pump or Electric Heating System of 25 kw or less*				
11. Automatic Night Set-Back Thermostat	2			
12. Electronic Furnace Ignition (Gas Furnaces Only)	2			Required
13. Fireplace Damper Integrity	1			
14. Duct and Pipe Insulation (Unheated Areas) - (R-5)	3			
15. Solar Heating or Solar House Design	5			
APPLIANCES WITH ENERGY CONSERVING FEATURES				
16. Window Air Conditioner (EER-9)	1			
17. Refrigerator	1	2 points maximum		
18. Dishwasher	1			
19. Clothes Washer or Dryer	1			
20. Stove or Oven	1			
21. Hot Water Heater	1			
TOTAL POINTS:				

Must have efficient air distribution system.

I have indicated the Energy Conservation Features that already exist in this home, or that are to be installed, and certify that the information is true and complete to the best of my knowledge and belief. I also authorize the Bank, or its designee, to inspect these Energy Conservation Features.

ENERGY CONSERVATION LOAN CHECKLIST

Description of Checklist Items

Conserving energy can effectively save money for consumers, as well as conserve natural resources. In the home, on the road, or during vacations, energy can be saved with substantial cash benefits. According to Seattle City Light, just the addition of ceiling insulation to standards required in this program may result in the savings of \$180 per year for an average home's electricity bill, (in an electrically heated home). Substantial fuel savings can be derived from the operation of a more efficient automobile or boat.

Conservation in the Home

In a typical Puget Sound area home, about 40 per cent of the heat generated by the furnace or heating system in winter is lost through an uninsulated ceiling. Another 16 per cent escapes through walls and floors, 18 per cent through windows and other glass areas and 10 per cent through doors and cracks.

House Shell Insulation

The most important and economical way to reduce heat loss is to insure that your home is properly insulated. Home ceilings, walls and floors should be insulated with material having a measurable "resistance value" or R value. The R value is a precise way of

measuring how much heat is trapped by various kinds of insulating materials. The higher the number, the better the insulation. Measuring ceiling or floor insulation with a ruler can determine the thickness of the insulation material (if any), and the R value can be determined by checking the kind of insulation installed.

There are many kinds of insulation commercially available, including mineral wool, cellulose-fiber, vermiculite and perlite, and plastic foams. Insulation values of R-19 for ceilings, R-11 for walls and R-11 for floors and R-11 basements have been selected as the minimum criteria for this program. This meets the levels suggested by the Federal Energy Administration.

* * * * *

1. Ceiling Insulation (R-19): Most home heat escapes through the ceiling. Among the most commonly used ceiling insulation materials are cellulose fiber (5-1/2 inches = R-19) and mineral wool (6 inches = R-19). Mineral wool is available in four foot rolls of "blanket" insulation, eight foot lengths of "batt" insulation, and loose shreds of insulation. Insulation can either be pressed in or poured in between ceiling joists.

2. Wall Insulation (R-11): To insulate walls in an existing house, holes are bored in the outside siding of the house and insulating material is poured in. Wall insulation includes polyurethane, polystyrene, urea-formaldehyde foams and vermiculite.

3. Floor Insulation (R-11): Floor insulation is installed much in the same way as ceiling insulation; batts or blankets of insulation are attached between the floor joists.

4. Storm Windows or Double Glazing: Uninsulated window space represents 18 per cent of the heat loss in a house. This heat loss can be cut in half by adding another layer of glass either by installing outside storm windows or permanent bonded double-pane windows.

5. Plastic Sheeting Over Windows: This is a seasonal method of insulating windows. Clear plastic sheeting is readily available and can be either stapled to the window siding or framed and attached to the window.

6. Storm Doors: Storm doors can be installed either by a professional installer or by the homeowner. An important consideration is the proper fitting of a storm door, and proper weatherstripping. Wood and enamel finish doors are better energy investments than aluminum doors, since heat loss is minimized.

7. Basement Insulation (R-11): Basements walls should be insulated two feet below ground level, up to the floor joists. Common insulating materials include loose cellulose fiber or blanket mineral wool. Typically, the insulation of this material is accomplished by attaching glass fiber blankets between 2" x 3" walls studs and covering with wallboard.

8. Window and Door Weatherstripping: There are many readily available weatherstripping materials which will block air flow under and around doors and windows. Most kinds are easily installed to fit either on the door or window, or the door and window jam. Caulking, or the sealing of cracked areas around door and window siding with caulking compound is an important and inexpensive energy saving measure.

9. Oil or Gas Furnace Rated at 75% (or higher) Efficiency:

Qualified service personnel can determine the efficiency of an oil or gas furnace during a home check. For oil furnaces, telephone the Oil Heat Institute of Washington at 623-8730 for a no-cost inspection. Tests of the furnace include temperature measurements, valve checks, oil nozzle checks, smoke tests and draft tests. By checking and adjusting furnace performance, significant energy improvements can result. For an older model furnace, replacement of parts may be necessary to improve efficiency. Please obtain a certificate from the inspection indicating the rated efficiency, and attach it to the checklist.

Additionally, an efficient air distribution system is required in a forced air heating system. The return air, supply plenum and ducting sizes, should be commensurate with the space heat requirements. An inefficient or inadequate air distribution system will negate the efficiency effect of the efficient furnace.

10. All Electric Heating Systems Including Heat Pumps: A heat pump is a central electric heating and cooling system which reduces electricity

consumption as much as 50 per cent. The electric heat pump operates by extracting heat from the outside air and is particularly desirable in the mild Puget Sound climate. It is the most energy efficient heating system available, but in addition, can provide air conditioning during warm weather. Other types of electric heating systems, such as electric furnaces and hot water baseboard systems, are acceptable if rated at 25 kw or less.

Also, an efficient air distribution system is required, as described in number 9 above.

11. Night Set-Back Thermostat: Use of an automatic thermostat can be a major energy saver in winter. The homeowner sets the temperature of the heating system to 60°; for example, for night-time heating in winter. This device can reduce overall home energy use by 10 per cent or more, depending on the normal daily heat setting.

12. Electronic Furnace Ignition: An electronic ignition system on a gas furnace saves 5 - 10 per cent of the fuel which is burned needlessly by the pilot light of an older furnace. This device is recommended for all homes using gas heat, and is required for new homes.

13. Fireplace Damper Integrity: All fireplaces should have dampers and the dampers should seal the chimney completely so cold air does not blow in. Fireplace damper integrity is easily checked by holding a lit candle in front of the fireplace when the

damper is closed on a windy day. If the flame is not disturbed, the damper is efficient.

14. Duct and Pipe Insulation (R-5): Heating ducts and hot water pipes often travel through unheated portions of the house. They should be insulated with duct wrap blanket insulation to prevent heat loss.

15. Solar Heating and Solar House Design: Solar collection devices for household water heating and home heating are available, and when properly used, can result in major energy savings. The proper design of a new home to maximize the collection of solar energy can be accomplished by careful planning of the home's south facing windows and siting. It is recommended that solar design plans be developed by or checked with an architect.

16. Window Air Conditioners: Air conditioning units are all labeled with an EER or energy efficiency rating, which indicates the energy efficiency of the appliance. The higher the number, the more efficient the air conditioner. An EER of 8 qualifies the homeowner for the energy conservation program.

17 - 21. Other Energy Efficient Appliances: There are a number of energy conserving appliances available commercially. Energy conserving refrigerators (and freezers) use as little as 1/3 the annual electricity consumption as conventional units. Savings are accomplished by minimizing features such as "no-frost" and maximizing

use of insulation. There is no national energy rating program for appliances, but purchase of appliances which are advertised as energy conserving by manufacturers will qualify these units for inclusion in the loan program. Please furnish a sales slip for proof of purchase of an appliance which is currently advertised as an "energy savings", as opposed to a standard model.

* * * * *

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NEWS RELEASE FOR OCTOBER 19, 1976

For further information please refer to Marketing Department 223-2101

SEATTLE TRUST ENERGY CONSERVATION LOAN PROGRAM

Report of Activity July through September, 1976

General

1. The program commenced on July 6, 1976.
2. Through interest rate incentives, the program is attempting to address energy efficient and economical living modes, particularly in rehabilitation of older homes and within the community's older neighborhoods.
3. The bank has several experimental inner-city activities in process, including that of underwriter of the Stevens Neighborhood Improvement Program and a pilot project of new construction in the East Denny neighborhood.
4. In addition to acceptable credit criteria based on an analysis of disposable income of each individual borrower, a reduction in interest below the bank's standard rate is granted to customers whose loan projects meet professionally established energy conservation criteria. The interest cost savings could amount to -

o Home Ownership Loan

Example: \$50,000 Loan for 30 Years

Interest Costs

Standard Rate 9-1/4% (9-1/2 APR)

\$98.082

Energy Conservation Rate 8-1/2% (8-3/4 APR)

88,405

Potential Interest Savings

\$ 9,677

<u>Home Improvement Loan</u>		<u>Interest C</u>
<u>Example: \$10,000 Loan for 10 Years</u>		
Standard Rate 9-1/4%		\$ 5,528
Energy Conservation Rate 8-3/4%		<u>5,039</u>
Potential Interest Savings		<u>\$ 489</u>
 <u>Automobile Loan</u>		
<u>Example: \$5,000 to 4 Years</u>		
Standard Rate 9-1/2%		\$ 1,029
Energy Conservation Rate 8-3/4%		<u>944</u>
Potential Interest Savings		<u>\$ 85</u>
 <u>Boat Loan</u>		
<u>Example: \$20,000 for 10 Years</u>		
Standard Rate 9-1/2%		\$11,056
Energy Conservation Rate 8-3/4%		<u>10,179</u>
Potential Interest Savings		<u>\$ 977</u>

5. The energy conservation criteria for qualifying for these loans was designed, in the case of housing, to provide substantially effective protection from heat loss and operating efficiency for a home in the Puget Sound region. The standards were developed by the members of the Cascadia Institute, under the direction of Wilson Clark who is currently special advisor for energy conservation to Governor Brown of California.
6. The home energy conservation criteria addresses potential strategies in three areas -
 - o House shell insulation
 - o Heating plant efficiency
 - o Appliances

Points are awarded for each criteria which must be fully met. Older and existing homes under \$75,000 in value must meet 20 points, including required points in -

- o Ceiling insulation (R-19: 5 points)
- o 15 additional points from the strategy the homeowners can best create

New homes and homes valued at more than \$75,000 must achieve 25 energy conservation points, including required points in -

- o Ceiling insulation (R-19)
 - o Wall insulation (R-11)
 - o Floor insulation over unheated areas (R-11)
 - o Double glazing or storm windows
 - o Weatherstripping
 - o High heating plant efficiency, including heat pumps
 - o Electronic ignition for gas furnaces
7. Since the program was inaugurated, the criteria has evolved and become better defined, particularly in respect to -
- o Points required for older homes
 - o Heat pumps
 - o Additional categories included for duct work insulation
 - o De-emphasis of appliance energy consumption
 - o Modification of floor insulation standards
8. Another major development has been the creating of a field force of para-professional home energy surveyors who make inspections on all home ownership loans and the larger home improvement loans. This field survey and report is supplemental to the regular field appraisal for value and basic habitability standards.
9. The high public visibility the program has received is reflected in -
- o Media coverage, locally and nationally
 - o Conferring with public energy conservation policy makers
 - o The response to the program by the public

The Record of Response
and Actions Taken through September 30th

1. More than 6,600 inquiries have been received since the program started.

Home Ownership	3,200
Home Improvement	1,500
Automobile	1,200
Boat	<u>700</u>

Total	6.600
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2. The bank has financed, or has in process, 931 loans of all types qualifying for energy conservation loan terms in the total amount of \$23 million as follows:

	<u># Loans</u>	<u>\$</u>
Home Ownership	110	\$ 4,700,000
Home Ownership in Process	266	12,200,000
Home Ownership, New Construction	54	3,000,000
Home Improvement	145	850,000
Automobile	266	1,000,000
Boat	90	1,250,000
Total	<u>931</u>	<u>\$23,000,000</u>

3. In addition, the bank has financed 247 loans of all types, totalling \$3,044,000, which applied for, but chose not to meet, the energy criteria, and were processed at the higher rate

	<u># Loans</u>	<u>\$</u>
Home Ownership	52	\$ 1,664,000
Home Ownership in Process	11	380,000
Home Improvement	40	230,000
Automobile	170	630,000
Boat	14	130,000
Total	<u>287</u>	<u>\$ 3,044,000</u>

4. The average loan sizes are as follows:

	<u>Energy Conservation</u>	<u>Standard</u>
Home Ownership	\$43,000	\$32,000
Home Improvement	5,800	5,800
Automobiles	3,700	3,700
Boat	14,000	10,000

5. Of the 511 applicants for home ownership loans, 81 were rejected for various reasons of either credit or property standards; 12 could not meet the energy standards, and obtained conventional financing.
6. Virtually all homes financed received some significant energy conservation treatment either before or after applying for the loan. All new homes embrace the total energy conservation criteria. Approximately 30% of the homes financed are newly constructed.

7. Approximately 35% of the homes financed are located in the older Seattle neighborhoods.
8. A sample of home improvement loans revealed the following types of conservation work undertaken:

Ceiling insulation	45%
Wall insulation	25%
Floor insulation	43%
Storm windows/glazing	28%
Weatherstripping	33%
Heating plant	53%

Summary

1. The program has been well received, and has aided the bank in providing an additional degree of service to the consumers in helping them qualify their home ownership commitment, in this case, by seeking significant energy savings.
2. The program has been profitable, and, in spite of higher loan demand, has brought with it new deposits which have assured that loanable funds will continue to be available.
3. The program will continue and will probably evolve more refinements as our lending officers become used to working with our customers and servicing needs. Also, we are anxious to see developments in both new technology and in the public policy area.
4. The interest rate incentive offered at the time a consumer makes an important financial decision appears to be an immensely successful approach to encouraging consumers to protect themselves against rising energy costs and to lower their energy consumption.
5. Although positive public programs are expected to address energy conservation, the capabilities of those in the private sector to take voluntary action in their own best long-range interest should be the crucial and by far the most effective response to the problem.
6. The impact of the program locally has spread far beyond the statistics gathered by the bank. Attention is called to the activities of home builders and owners of existing homes who have been calling their fuel dealers and insulation contractors with reference to the Seattle Trust standards.

SEATTLE TRUST ENERGY CONSERVATION LOAN PROGRAM

The Seattle Trust and Savings Bank has been offering since July 1976 a new consumer loan program designed to promote energy conservation in home ownership, home rehabilitation, automobile usage, and recreation.

The bank offers loans at advantageous rates and terms if the bank customer takes positive steps to adopt sound energy conservation and efficiency standards. The standards were designed for the Seattle Trust program by Wilson Clark of the Cascadia Foundation, in consultation with the Federal Energy Administration, the Environmental Protection Agency, State and local governments, and many utilities and professional associations. Summaries of these standards are provided by the bank in the form of a checklist.

Qualifying customers currently receive up to 30-year home-ownership (mortgage) loans at 8-1/2 percent, 10-year home rehabilitation loans at 8-3/4 percent, 4-year automobile loans at 8-3/4 percent, and 10-year boat loans at 8-3/4 percent. The interest differential between the bank's standard loans and energy conservation loans ranges from 1/4 to 1/2 percent.

To qualify for an energy conservation home-ownership loan, a bank customer would have to provide at least a 20 percent down payment on the appraised property valuation and see that the house meets at least 20 points on a scale of 30 within the bank's energy conservation criteria. These include insulation of the outer shell, heating system and appliance efficiency, and innovative conservation strategies such as heat pumps and solar energy. New and more expensive homes would need to fulfill more conservation criteria to

qualify than older homes, although all homes would need to employ substantial conservation strategies to meet the criteria. The bank does not warrant any cost benefit, and leaves it up to the home owner to devise the best strategy to obtain the qualifying points. Bank personnel trained in home energy conservation design accompany the bank's field appraisers.

The qualifying criteria for a home rehabilitation or improvement loan stipulate that a substantial portion of the loan be used to retrofit or improve the house to meet these same standards.

A rehabilitation loan may be used in conjunction with a home-ownership loan. The bank will lend both to homeowners purchasing on contract, and those who perform their own work. The loan program is available only to owner (or purchaser) occupants. The bank permits the conservation strategies to be implemented over a 90 day period.

Auto loan customers receive an 8-3/4 percent rate of interest for 4 years on new automobiles that are EPA rated to obtain 25 miles or more per gallon of gasoline on the highway. The bank noted that 240 models of the 1976 cars qualify under this criterion. The 1977 and future years' EPA ratings may result in new criteria being established.

Boat owners will also receive the benefit of lower rates if their boat's main propulsion plant is energy efficient. This includes most sail craft and also those power boats whose engine and hull characteristics have the best potential for energy efficiency. This latter category includes full-displacement hulls, semi-displacement hulls if diesel powered, and small outboards under 25 hp.

Boat loans were specifically included for special credit consideration because of the bank's long commitment to safe and energy efficient recreation as an important adjunct to Northwest living.

The Record of Response
and Actions Taken through December 31st

1. More than 11,211 inquiries have been received since the program started.

Home Ownership	5,005
Home Improvement	2,403
Automobile	2,745
Boat	<u>1,058</u>
Total	<u><u>11,211</u></u>

2. The bank has financed, or has in process, 1,564 loans of all types qualifying for energy conservation loan terms in the total amount of \$28,681,000, as follows:

	<u>#Loans</u>	<u>\$</u>
Home Ownership	274	\$11,549,000
Home Ownership in Process	204	10,789,000
Home Improvement	261	1,527,000
Automobile	665	2,461,000
Boat	<u>160</u>	<u>2,355,000</u>
Total	<u><u>1,564</u></u>	<u><u>\$28,681,000</u></u>

3. In addition, the bank has financed 797 loans of all types, totalling \$5,428,100, which applied for, but chose not to meet, the energy criteria, and were processed at the higher rate.

	<u>#Loans</u>	<u>\$</u>
Home Ownership	58	\$ 2,129,100
Home Ownership in Process	15	453,100
Home Improvement	118	706,800
Automobile	582	1,926,600
Boat	24	212,500
Total	<u>797</u>	<u>\$ 5,428,100</u>

Summary

The bank has every expectation that these basic strategies for consumer energy conservation will be amplified by customer suggestions and new technology, and in fact are being continually refined. It is hoped that the program will evolve over time to include other accredited means of energy economy.

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The Second Cycle

Within the past few months, several banks have inaugurated conservation financing programs similar to those of 1973-74. A brief description of these newer programs follows:

The Second Cycle - Selected Program Examples

Brenton Banks
Des Moines, Iowa

The Brenton Banks have recently initiated a heavily-advertised energy loan program: loan rates for customers investing in energy-related home improvements such as insulation have been reduced from 11-13% to 9%. In addition, loan rates on new automobiles decreased as the miles-per-gallon ratings increased; the lowest available rate, for a new automobile rated at 35 mpg or more, is 9 3/4%, a 3/4% reduction. The program is scheduled to run through June 15.

City Savings Bank
Middletown, Connecticut

The bank has recently advertised itself as "The Energy Bank." For new automobiles rated at 20 mpg or more, loans are available at 9 1/2%, a 2% savings. Energy conserving home improvement loans are also reduced by 2%. In addition, the bank is working with a developer whose new homes are equipped with additional insulation; mortgage rates are reduced by 1/2% for customers purchasing such homes. Promotion for the program also stresses the fact that the bank is building a new main office heated and cooled by solar energy. Promotion is expected to continue through the year.

First and Merchants
National Bank
Richmond, Virginia

As of March 1, 1977, all 95 branches of the bank are offering a 10% discount on energy conserving home improvement loans. The program is being heavily promoted, using all media throughout the state. It is scheduled to last through May, but depending upon consumer response, the bank may extend the program.

New Jersey National Bank
Trenton, New Jersey

In February of 1977, the bank began promotion of home insulation loans as part of its regular home improvement loan program. No special rates or terms are offered.

Northwestern National
Bank Corporation
Minneapolis, Minnesota

Starting on March 1, 1977, 24 bank affiliates of this holding company began heavy promotion of energy loans: available reductions on energy conserving home installment loans range from $3\frac{3}{4}\%$ - 1% below normal installment credit rates. In part, the program is an outgrowth of the company's continuing commitment to housing rehabilitation activities in the state of Minnesota. Promotion is scheduled to continue through October.

Society for Savings
Hartford, Connecticut

In February, the bank reduced its home improvement loan rates from 11% to $8\frac{3}{4}\%$ on loans for energy improvements such as insulation, siding, and storm windows. The medium-sized radio and newspaper campaign is scheduled to last through April.

Southern Bank and Trust
Richmond, Virginia

For several weeks in January, the bank offered emergency energy loans to people having difficulty paying their heating bills; the first payment on the loan could be deferred for 90 days. The bank also offered to extend the repayment period for current borrowers at the normal fee for loan extensions. The program was heavily promoted for a few days; it has since been discontinued.

Winters National
Corporation
Dayton, Ohio

A participant in the "first cycle," this bank began promoting its "Winterizer Loan" program last winter. For energy conserving home improvement loans, the bank offered a special rate of $7\frac{1}{2}\%$; in addition, the bank affiliates paid one-third the cost of energy-related home improvements for their employees, up to a \$300 bank contribution. The program is still active and will be evaluated in the spring.

It is too soon to evaluate the success or failure of these newer programs in terms of increased customer business, but most have enjoyed extensive free local publicity. Again, in the words of those involved:

"Getting your name out in front of people is the important thing."

"It's caused a lot of stir in the industry, but we're not going to make a lot of money on it."

"We felt that it was a very timely position for the bank to take."

"As a business device, there is definitely PR value."

"It just seemed like the proper thing to do."

"We got just absolutely terrific publicity. We couldn't have bought that kind of publicity at any price."

"We don't know of any other banks doing this kind of program."

"We see it as a creator of traffic, and traffic is the name of the game."

"Is it worth all the paperwork? You've got to get extra customers to justify it."

"We did it as a real commitment on the part of the bank to get people to conserve energy and to help the local community."

"We just figured, who cares? We're not making a lot of installment loans anyhow."

"It hasn't generated a tremendous amount of volume."

"Frankly, the demand hasn't been overwhelming."

A review of past and present bank efforts in the conservation area revealed that apparently less than 1% of the nation's 14,500 banks have attempted any form of energy conservation programming. Most of the banks involved in these early efforts have been medium and small-sized institutions in disparate locations. Of the banks who have entered this area, less than half have gone so far as to offer financial incentives in the form of reductions in interest, extended terms, flexible repayment schedules, or other special premiums to conservation customers. Thus, there is obviously great potential for an expanded role for banks in this field by increasing the number of banks involved, widening the geographical coverage conservation programs, and utilizing the resources of larger bank and banking industry organizations.

8. WHY HAVEN'T MORE BANKS DONE MORE TO ENCOURAGE CONSERVATION?

WHILE BANKS ARE NOT AGAINST ENERGY CONSERVATION, NEITHER ARE THEY ESPECIALLY INTERESTED IN PROMOTING IT AGGRESSIVELY. CONSERVATION RETROFIT INVESTMENTS IN THE \$200 - \$1,000 RANGE ARE NEITHER PARTICULARLY ATTRACTIVE NOR FINANCIALLY FEASIBLE AS HIGH PRIORITY BANK BUSINESS OPPORTUNITIES. IN ADDITION, MANY BANKS VIEW THEIR ROLE AS RESPONDING TO THE MARKETPLACE RATHER THAN LEADING IT. AGGRESSIVE CONSERVATION PROGRAMS MAY INVOLVE CHANGES IN ROLE AND PRACTICES WHICH MANY BANKS ARE RELUCTANT TO MAKE. BANKS ARE LARGELY UNAWARE OF WHAT HAS BEEN DONE IN THIS AREA, AND FIND THE INCONVENIENCE OF DESIGNING THEIR OWN CONSERVATION PROGRAMS A SIGNIFICANT BARRIER.

As indicated in the prior section, banks have been largely uninvolved in encouraging energy conservation activities by homeowners and renters. What are the reasons which underlie this sparse record? Based upon our conversations with bankers and our review of literature in this field, there seem to be several major explanations, stemming from a combination of financial realities of bank operations, prevailing attitudes and philosophies within banking circles, and the marketplace for financial services.

The \$1,000 Threshold

Most banks lose money on direct personal loans of less than \$1,000 - \$1,500. The Functional Cost Analysis of the Federal Reserve Bank indicates that banks would have to charge roughly 17-20% effective interest rate annually just to break even on a \$750 monthly installment loan for 24 months, and over 28% on a \$500 one-year loan. These data are based on average costs for loan origination, servicing, cost of money, and loan losses. The actual break-even points for specific banks will vary, and particular loan transactions would be evaluated on the basis of marginal costs; but these figures suggest the financial realities of the direct lending business with which banks must contend. Since it costs roughly the same to make and service a \$20,000 loan as it does for a \$500 one, over the same term, banks are interested in increasing the size of the loan over which their fixed costs can be spread.

Most energy conservation products and projects cost less than \$1,000. For example, attic insulation jobs may cost as little as a few hundred dollars, with items such as clock thermostats, storm doors, and others costing even less. Even "packages" consisting of several conservation hardware items may not pass the \$1,000 level. Those items which cost more than \$1,000 tend either to be less frequently acquired by consumers (e.g., longer replacement cycle for major heating, ventilation, and air conditioning equipment and systems), or of questionable cost-effectiveness compared to smaller retrofit investments.

Simply adding together enough individual conservation products to satisfy the \$1,000 threshold is not a promising strategy. First, the larger the investment required of consumers, the less interested most become in buying conservation measures. Second, existing evidence suggests that investments in multiple conservation items become less cost-effective beyond a certain point, whether evaluated on the basis of the time necessary to recover first costs, or on a more sophisticated life-cycle cost basis. The cumulative cost-effectiveness of several items installed together is largely unknown at present.

Thus, the offering of direct consumer loans for the acquisition of the vast majority of conservation items -- even at normal rates and terms -- appears to be an unattractive venture to many commercial bankers.

The "No Man's Land" Of Many Conservation Investments

In other areas, banks have dealt with the financing needs for such moderate-sized transactions through the medium of revolving or open end credit. This allows them to incur origination costs only once in establishing the credit ceiling or line of credit available to the card holder or check over-draft client. But there are obstacles associated with this strategy, too, in the case of energy conservation purchases.

While many conservation retrofit investments fall below the break-even point for banks to be able or willing to offer direct personal loans for their financing, they also lie above the normal level of credit used by holders of credit cards or checking over-draft/instant credit accounts. For the millions of bank credit card holders, the average purchase size is under \$30. While such cards may be convenient for conservation investments in the \$5 - \$100 range, they are rarely used for purchases of several hundred dollars, e.g., most insulation projects. Furthermore, this form of credit involves the highest interest rate for consumers, usually on the order of 18% annually. Even at this rate, many banks lose money on their credit card and other revolving credit plans, making them unwilling to voluntarily offer rates or terms more favorable to the borrower.

The Cash Buyer Phenomenon

Evidence from several utility company programs which offer convenient, competitively-priced credit to customers for financing insulation or other conservation retrofit projects strongly indicates that most consumers who make such investments will pay cash instead. For example, less than 0.5% of the 80,000 individuals participating in the insulation program of Michigan Consolidated Gas Company utilized the financing option which allowed customers to pay for the project on their monthly fuel bill. Similar, if less dramatic experience has been shown in other comparable programs.

To the extent that people are able and prefer to pay cash for most retrofit investments costing less than \$500, there is little incentive to either the bank or the individual in offering dramatic modifications of current financing techniques. The people who cannot afford to pay cash for such items would also tend to have the hardest time satisfying credit eligibility standards for any form of bank credit.

Can The Tail Wag The Dog?

At the present time, widespread consumer demand for energy conservation products and services remains to be convincingly demonstrated. While increasing, the level of that demand is relatively low when compared with other potential consumer expenditures for which bank services are used. Banks are not being swamped with consumer requests for financing of conservation hardware; in fact, few banks have received more than a handful of such requests, if any. In the face of such apparent consumer apathy, banks are reluctant to commit limited resources to design and promote innovative financing programs.

The demand for bank services tends to be derived from that for the specific goods or services being acquired by consumers, and not the other way around. Many banks have recognized the limits on their ability to stimulate primary consumer demand for specific items by making bank financing more attractive. The feeling is that individuals will not buy a car or a house because they can thereby qualify for a special lower-rate loan or mortgage; but that if they were thinking about or planning to buy an automobile or home anyway, they might be willing to try to qualify for a special financing offer. Also, many consumers are not apparently sensitive to variations in the terms of the financing they use, focusing more on the price of the item itself.

Furthermore, the smaller the purchase, the less likely consumers may be to shop around for credit. The experience of the Seattle Trust program outlined earlier suggests this phenomenon: while a significant amount of mortgage business was attributed to the lower interest rates offered to borrowers who invested in specific conservation features, the response to reduced rates on home improvement loans for comparable projects was disappointingly low. Thus, the smaller the amount of the investment, the less leverage banks may have in stimulating consumer demand by restructuring their financing services.

This Kind of Program Goes Against the Grain

There are certain traditions in bank practices and philosophy which are viewed by some as incompatible with playing an aggressive role in conservation programs. Not all banks place comparable weight on these considerations, but most share one or more of the following concerns:

- Most banks do not care what consumers acquire so long as they can repay whatever money they borrow. It is viewed as counterproductive to place strings on the purposes for which bank services can be used.
- Banks are usually reluctant to get into markets or play roles with which they are unfamiliar. Conservation programs requiring physical inspection of homes and apartments either to assist consumers in selecting particular conservation items, or to certify that such items were acquired and adequately installed, are likely to be opposed by many banks. They view such activities as not only unfamiliar but as increasing their costs in an already high cost segment of their lending business. Those non-traditional businesses which banks have entered -- often under the aegis of bank holding companies -- have included such activities as data processing, real estate and capital equipment leasing, investment counseling, and bookkeeping services. The appeal of the residential conservation retrofit business remains to be seen, but appears to be weak from the perspective of most banks when compared to these other areas in which they are more experienced.
- One problem perceived by some bankers is the poor market image of the home improvement business in the minds of the public. Banks are unwilling to pursue cooperative marketing or indirect lending strategies with other businesses whose reputation, competence, or integrity may be questionable. The dispelling of the image of the "suede shoe" operator will remain a significant problem for legitimate home improvement contractors interested in collaborating with banks in tapping the potential conservation retrofit market.
- A few bankers also mentioned a concern that conservation programs might backfire as have other previous public service efforts by some banks. By offering unique or favorable treatment to this type of consumer investment, the bank might open itself to demands for comparable treatment for a wide range of other public interest activities, e.g., reduced rate loans for renewable resource technology, special commercial loan treatment to novel businesses with strong anti-pollution records, etc.

- Furthermore, there is competition within the bank for marketing and program development funds, as various departments strive to improve their respective functional areas. Depending on national and local economic conditions, the cost of funds to the bank, its liquidity position, and prevailing consumer and commercial demand for borrowing, among other factors, banks will shift their attention to different aspects of their service line under different situations. Thus, during one period a bank might stress commercial lending, in another automobile lending, and savings account business in still another. Unless and until energy conservation lending promises to become a profitable and large segment of the bank's business, its competitive appeal in these internal bank budgeting and portfolio decisions is likely to remain extremely limited.

The Bother and Inconvenience of Developing Conservation Programs

Given the apparent limited consumer appeal and marginal profitability of many conservation investments, most banks seem largely unwilling to spend the kind of time and resources (as did, for instance, Seattle Trust and Savings) in designing and promoting their own conservation programs. They are looking for easy to adopt program ideas which can be readily integrated into their business operations. This raises the need for a synthesis of what has been done by other banks in this area, and creative packaging of support materials (forms, sample advertisements, lobby displays, and the like) to make a bank's adoption of conservation activities as convenient and straightforward as possible. Without this clearinghouse function, many banks will either choose to avoid the effort of designing a conservation program from scratch, or repeat the mistakes of other banks.

Many bankers contacted during our study raised the question: Why us? Pointing out that other parties such as utilities, or manufacturers and distributors of conservation products and services have a more direct and immediate vested interest in promoting energy conservation, these bankers resist assuming the leadership in stimulating consumer demand in an area where they are only peripherally concerned.

Having reviewed past bank efforts and possible motivations and concerns about bank conservation programs, we now turn to an examination of what banks might do to encourage conservation in each functional area.

9. WHAT MORE COULD BANKS DO?

BANKS CAN ENCOURAGE ENERGY CONSERVATION BY MAKING SOME CHANGES IN THEIR CURRENT OPERATIONS. THESE CHANGES, WHILE RELATIVELY MODEST, ARE NONETHELESS IMPORTANT AND COULD TAKE PLACE IN THE AREAS OF MARKETING AND PROMOTION, DIRECT LENDING, INDIRECT LENDING, CREDIT CARDS, SAVINGS AND TIME DEPOSITS, AND CHECKING ACCOUNTS.

In the short to medium term it is less important to get banks to do completely new things than it is to encourage them to adopt the programs now in use by a small number of their counterparts around the country, and to stimulate them to adapt techniques that they already use to conservation-oriented purposes.

The evidence gathered during the course of this research and summarized in the prior eight chapters of this report suggests the limitations that tradition, economics and regulation place upon the efforts of commercial banks, acting without public subsidy, to stimulate consumer investments in energy conservation devices and products. From the perspective of the banking industry, the role of commercial banks will tend toward offering relatively modest (rather than radical) changes in the banks' product lines to attract the energy conservation investor. Bankers see their principal role as facilitating hardware acquisition and ensuring that sufficient funds are available for interested consumers, rather than promoting such dramatic programs as "no-interest" loans or cash grants. Bankers believe this to be reasonable given three factors -- one, operating costs will not allow dramatic changes in product lines; two, banks will be more able and willing to mount programs that are manageable, and based on techniques tried in other areas; and three, they feel customers will be more interested in programs that they can understand or are familiar with.

The opportunities to encourage energy conservation in the areas of marketing and promotion and direct and indirect lending described on pages 4 to 9 of this report can be woven into the three strategies for ERDA action developed in detail in the next chapter. As indicated in the preface we have taken several of the ideas considered most promising by bankers, and described them in more detail in the following pages. These program ideas could form the basis for a series of pilot or demonstration projects in various parts of the country.

The ideas chosen for description as pilot projects are as follows:

- flat rate interest reductions
- variable rate interest reductions
- gifts, premiums or cash rebates
- mortgage interest rate reductions
- contractor lines of credit
- energy loan pool
- integrated marketing projects
- large group marketing
- bank energy center

Each idea is briefly described, the reason why it is worth demonstrating is developed and, finally, there follows a brief discussion of issues and problems of implementation.

Demonstration Program: Flat-Rate Interest Reduction

Brief Description: Banks would offer reductions in interest rates to personal or home improvement loan customers for money to be used for conservation devices or materials. The best model for such a program is that offered by Seattle Trust and Savings.

Rationale

There are two basic reasons why this strategy may yield useful results. First, for those consumers who are undecided about conservation investments, visible marketing of an attractively designed interest-rate reduction program may trigger conservation acquisitions of an "If I'm going to do it sometime, I might as well do it now and take advantage of this program" basis. This type of program may produce the stimulus to convert a favorable attitude into positive action for those consumers who are only partially convinced that such an investment is worthwhile. Inducing conservation investments by those who might not otherwise do so is a strong rationale for governmental sponsorship of such programs.

Second, if the interest rate reduction on home improvement loans is applied to the entire loan amount (rather than only the conservation items) then the consumer has a twofold benefit -- a reduction in the cost of both home improvement and conservation investment -- which could be substantial. This incentive might be attractive enough to encourage consumers to add conservation improvements they had not previously considered into their home modernization project. Such a program might increase the bank's home improvement loan volume enough to justify the reduced profit margins from the lower rates.

Interest-rate reduction has been a common device to attract customers and to reduce costs of products or services to consumers. It is a standard technique in the public sector, especially in housing. From the viewpoint of participating banks it has the advantage of being a well known, tested mechanism, utilized frequently to attract business. In spite of the fact that interest-rate reductions are a familiar device in bank services marketing, there is little or no definitive evidence as to their effectiveness. Within the industry opinion varies. Some bankers favor its use; some use it but are doubtful of its impact, and some are convinced that most customers don't comparison shop or that interest-rate reductions are only attractive for very high amount, long term borrowing such as mortgage loans.

*A detailed description of the Seattle program is included on page 43.

Implementation

Reduced interest rates could be offered for purchase of conservation items or for home modernization projects that included at least a basic set of "required" conservation measures on an "approved list" promulgated by the bank. A definitive list of eligible measures is critical. It obviates the need for bank personnel to make case-by-case judgments on what is a qualified measure and what is not. The list can be set up using FEA standards, EPA guidelines, or in consultation with state government and local utility companies. Under the provisions of Public Law 94-385, FEA is preparing a list that could form the basis for a bank selection of eligible measures.

Certification that borrowers actually purchase and install the required measures could be handled in one of two ways. First, and simplest, by voluntary self-certification whereby the borrower promises to comply with the terms of his or her loan. This is basically an "honor" system. Second, the bank or a participating organization (utility, contractor, etc.) could physically inspect borrowers' homes on a sample or universal basis. The costs of this activity could be significant, but it also has the potential for providing useful follow-up advice to customers regarding use and maintenance of the measures. Administration of this program could be handled within the loan department and the aggressive bank could establish mutually helpful relationships with, for instance, utility companies and contractors.

Potential borrowers frequently feel they need assistance in diagnosing their energy problems, understanding their alternatives or choosing solutions appropriate for their home and pocketbook. This counseling could be done by bank officers, however, few banks would want to do the field work required to do this adequately. Arrangements could be made with utilities for this diagnostic service, and banks could have a "recommended list" of licensed contractors to whom they refer borrowers (and, of course, vice versa).

Such arrangements would be advantageous to both parties, but are not indispensable for the program's success. Some banks would be reluctant to endorse contractors; other banks might conclude that the incremental benefits of linking with utilities were not justified by the costs. These issues can only be resolved in the design of programs by individual banks, taking into account the bank's unique cost structure and existing relationships with other groups.

There are a variety of promotional themes for an interest-rate reduction program, designed to appeal to different bank customers. Advertising in magazines like Sunset, House and Home and Popular Mechanics could reach people who are either (or both) ecologically sensitive to energy issues and/or likely to undertake do-it-yourself or professionally done home projects. Bank lobby displays, brochures and credit card stuffers would reach regular bank customers. Existing bank mortgage holders could be informed about the program through special mailings, or with stuffers in their mortgage payment statements. These are illustrative examples; as stated in Chapter 3, there are multiple messages that could appeal to various consumer attitudes and characteristics.

Interest-rate reduction programs could be encouraged in every major bank trading area. However, special attention should be given to large, multi-branch banks (in branch banking states) where establishment of such a program could achieve wide coverage. It should be attempted also by well known "leader" or "lighthouse" banks; their programs are frequently emulated by other financial institutions. Obviously it might increase consumer and bank acceptance if interest-rate reductions are fostered in those areas of the country where energy costs and problems are severe enough to provoke high levels of consumer interest.

Demonstration Program: Variable-Rate Interest Reductions

Brief Description: Banks could offer a range of interest-rate reductions, (from, say, 1/2% to 3%) the rate tied to the level of energy conservation achieved by the consumer's purchase or project.

Rationale

This program idea, while basically a variation of the flat rate interest reduction, is aimed at solving two important problems associated with consumers' attitudes and behavior regarding acquisition of energy conservation technology. First, energy conservation investment opportunities occur at different times and in different areas of the consumer's life. Some are major and present the chance for significant savings; some are minor, yet combined with other minor improvements, could produce substantial benefits. Consumers are especially first-cost sensitive on investments that are utilitarian in nature and investment in conservation items is minimized. It is done on an item-by-item basis only as needed, and is rarely considered as a long-term comprehensive investment strategy advantageous to the wise consumer.

Ways must be found to encourage consumers both to think in terms of overall energy use patterns and to adopt more comprehensive solutions. Offering progressively lower interest rates tied to increasing energy savings as an incentive for consumers to purchase conservation improvements in one "large economy size" package (improvements that they might otherwise acquire incrementally over a long period) could significantly increase short-term energy savings.

Implementation

The variable rate plan is an elaboration of the flat rate interest reduction plan. It would use similar administrative procedures and materials. The flat rate loan could establish basic energy conservation measures required to qualify a borrower for a loan. The variable rate would go beyond this. It would offer, for example, an additional 1/2% reduction in rate for every additional conservation investment (rated on a simple point system). The scoring system might also be weighted to reflect the cost of improvements or purchases, with rate reductions being larger for cumulatively more costly "packages" in order to encourage consumers to put together packages of construction/shell improvements, large appliances and smaller devices.

This program could be promoted to all bank customers but targeted on the more affluent borrower whose income is high enough to make such alternative, larger investments a real option. It could be set up with a theme appealing to the more sophisticated customer, using messages appealing to the "savvy saver" or the "energy economiser."

Demonstration Program: Gift, Premium or Cash Rebate

Brief Description: Banks could offer a cash rebate, whose size would vary according to the amount of the loan or the number or amount of energy conservation measures. Alternatively, banks could offer an actual premium or gift (either energy conservation related or not) for energy conservation borrowers.

Rationale

From a bank's point of view premiums or cash rebates may be a worthwhile strategy to attract energy conservation borrowers, since interest reductions tend to be quite costly over the life of a major loan. Cash rebates can be relatively small (\$10-\$100) and still be appealing to the first-cost sensitive potential borrower who gets the incentive immediately and in its most tangible form, rather than receiving it gradually, almost invisibly, over the life of the loan.

The experience of at least one utility company (Brooklyn Union Gas) suggests that cash rebates may be quite attractive to potential borrowers. A San Francisco bank ran a very successful promotional campaign for personal loans in 1976 featuring a \$50 cash rebate. Premiums are, in essence, the in-kind equivalent of a rebate. Premiums have legal limitations upon the value of the gift that lessen their attractiveness by confining them to smaller items. However, their marketing appeal may overcome their size limitations and they (along with cash rebates) have been used extensively by banks, especially to attract both checking and savings depositors.

Implementation

A rebate program could be set up as an independent activity, with the bank promoting only the rebate; or it could be organized in concert with both flat rate and/or variable rate interest reductions, as one of a series of incentive options from which the consumer could choose. As an isolated program, it could be administered relatively simply in conjunction with normal personal and home improvement loan activities. If done along with interest-rate reductions, some form of the "approved list" for eligibility would be required. If the value of the rebate were tied either to the number of energy conservation measures adopted, or their cost, (the "variable rebate" in other words), then the "approved list" would need an energy efficiency or energy saving value for each measure. Promotion of rebates and premiums could be oriented toward fence-sitters ("Been thinking of storm windows? We'll give you \$50 if you install them this year.", or "Been considering insulating your attic? We'll buy you your first roll of insulation.").

Demonstration Program: Interest-Rate Reductions on Mortgage Loans

Brief Description: Banks could offer lowered interest rates to mortgage borrowers who either buy homes that are already energy efficient, or agree to undertake energy conservation improvements. In the latter case a mortgage "add-on" could be written at the same special rates to cover these costs.

Rationale

Given the current reluctance of many consumers to invest in conservation measures, it is vital to access the energy user at a time when conservation is, or could be, incorporated in the consumer's decision-making. As little as 1/4% off the standard rate represents a significant saving on a \$60,000, 30 year mortgage. Few decisions are more important for most consumers than the purchase of a home.

Thus, the incentive offered by a specially reduced interest rate program could be substantial enough to make it worthwhile for consumers to invest in significant energy conservation measures, especially if the monthly carrying cost of these could be minimized by adding them to the mortgage. This type of program builds on the fact that at the time of purchase the homebuyer is much more willing to consider major home improvements. The Building and Supply News Annual Survey of Home Improvements has found that most major home improvements are done within the first year of purchase and the likelihood of such improvements diminishes rapidly thereafter.

Implementation

Consumers do shop more carefully and more extensively for mortgages than they do for personal or home improvement loans. This type of program is an opportunity to capitalize on this for energy conservation purposes. The program would have two elements: (1) Loans at special rates for new homes that met bank approved standards and (2) loans at special rates to home buyers who agree to bring their newly purchased existing homes up to bank-approved standards. Both parts of the program could be housed in the real estate loan department of the bank, but would be marketed and promoted differently.

New Homes: banks would operate through builder/developers. The bank's program would allow builders to offer the homebuyer an advantageous financing rate as part of a complete house and financing package. Working through bank approved builders has several complementary advantages. It uses the builders' marketing to promote a bank service (thereby reducing program costs). It encourages builders to risk adding to their homes the cost of oftentimes invisible energy conservation improvements by giving them an attractive package to offer the buyer. It offers the consumer substantial savings on financing costs, as well as holding out the added benefit of prospective savings in energy costs. Working through approved builders should also make

certification of compliance with bank approved energy standards considerably easier and less costly by setting up relationships in advance with reliable pre-qualified builders offering quality products.

Existing Homes: an "energy audit" using bank approved standards would become a part of the bank's appraisal process, conducted either by the bank's in-house appraisers or as a contract service. Buyers wishing to take advantage of the lower rate mortgage loans would be told if their prospective purchase qualified, and if not, what was required to bring it up to the bank standard. The work could, at the consumer's option, be financed either independently of the bank, through a home improvement loan or, if desired, through a mortgage add-on. The mortgage add-on reduces the monthly costs of such a loan substantially, but the total financing charge over the life of the loan is considerably greater. Optional features could be added to an interest reduction program. Down payment requirements could be changed to benefit the energy conscious buyer (from 25% to 20%, for example); payment terms altered (perhaps through deferral of first payment); the borrower's credit limit increased by including energy costs in calculations of borrower's ability to carry the mortgage.

The existing housing program should work best initially in those areas where the housing stock is older, the climate is severe and/or fuel costs are high -- e.g., the Northeast and areas of the Midwest. the new housing program would be best aimed at sunbelt communities of the South and Southwest where new housing markets are strong and major residential development is still in progress.

Demonstration Program: Contractor Line of Credit

Brief Description: Banks could provide contractors with a line of credit that would enable them to offer the consumer quick and attractive financing for conservation home improvements as part of a "package deal." The model for this is the auto dealer who offers financing to buyers, his paper then taken by the bank.

Rationale

Banks have limited budgets for marketing of specific services. Working with building contractors whose principal product line is remodelling could be an excellent way to generate new conservation financing business, and to take advantage of the opportunities that integrated marketing and selling presents to "piggyback" the resources of other groups with vested interests in conservation. In addition, it improves the ability of the consumer to meet his or her conservation needs easily on a "one-stop shopping" basis. If the desired investments in conservation hardware are to take place quickly, easy access and convenience to the consumer must be emphasized.

Implementation

This program could be undertaken in concert with the local chapter of the National Home Improvement Council. They would assist the bank to identify a listing of interested licensed, reputable contractors qualified to specify and install conservation hardware. If necessary, the bank and the Council could conduct a workshop with these contractors to ensure that all of them adequately understand the diagnosis, specification and installation of conservation hardware.

The bank would offer these pre-qualified contractors a line of credit. This could consist of a variety of financial packages, each one tailored to the type and costs of hardware and to the customer's pocketbook. For instance, contractors would be able to offer BankAmericard or Mastercharge for these items in the \$500 or less category; a simplified procedure for medium sized loans, perhaps an "energy loan hot line" or "phone loan" (the contractor or the customer would phone basic information into the bank for quick approval and closing of the deal); for large projects contractors could offer convenient access to home improvement loans, or offer "special terms" -- lower interest rates, deferred first payment, and loans based on the homeowner's equity. The procedural aspects (forms, credit checks, etc.) would be designed to make financing easy for the customer and the process convenient for the contractor.

While one advantage to banks is that contractors would be "finders" of new business, banks could also promote the program themselves, making general information and contractors' names available to customers who ask for advice and guidance. They could also market the program through credit card bill stuffers, lobby displays, or follow up "after-marketing" with mortgage holders.

Demonstration Program: Energy Loan Pool

Brief Description: Banks within a metropolitan region would establish a low interest rate energy conservation loan pool program. The source of funds for these programs would be a revolving loan pool, contributed to by each bank in some agreed upon ratio. The model for this is the loan pools established by banks for urban mortgages and rehabilitation loans.

Rationale

Earlier in this report several reasons were given why banks might be interested in energy conservation financing programs. The most powerful was profit. It may be that banks are unlikely to enter the energy conservation financing area without significant public sector help and encouragement. Yet the motivation of corporate public relations should not be overlooked. Banking is a much regulated and often criticized area and if banks do not as yet feel that there is sufficient consumer interest to merit a purely profit-oriented initiative, a "social responsibility" motivation could still be attractive and lead to two beneficial results. One, through setting up a "loan pool" type of program and administering it, banks would become more informed about energy issues and program possibilities. This would lay a useful foundation for future efforts when consumer interest in energy conservation is sparked by either rising prices or government regulation. Two, in the short term, attractive financing would be available to those consumers who needed it or desired it.

The "shared risk" or "loan pool" concept was originally developed to reduce any individual participating bank's risk and exposure in urban situations where they were asked to lend to people with lower credit ratings or on homes in supposedly marginal areas. Applied to energy conservation lending, it has a slightly different purpose, although the central idea of spreading and reducing costs is the same. Energy conservation loans are not inherently risky. In fact, since the majority of such loans will be to homeowners they are relatively sound, compared to personal and other loans. However, given their size and the need to make them attractive through interest-rate reductions, they would be less profitable than other uses the banks might have for disposable funds. A loan pool would generate a large volume of funds for mortgage and home improvement energy conservation loans at low interest rates, but would reduce to a minimum the risks and/or losses to any individual bank attributable to the lower profitability of energy conservation lending.

Implementation

Participating banks would pledge an agreed upon amount of loan funds, either in equal shares or pro-rated by bank size. The distribution of the funds could be done in several ways. Each bank could have its own energy conservation loan program within its personal lending department, utilizing resource materials ("approved lists", application forms, brochures, etc.) developed by a central study or resource group from all participating banks. Each could draw down loan funds as needed. The pool would revolve as loans were paid off. If it could not revolve fast enough to keep up with demand, either a secondary market could be set up or banks could step in with their own programs at advantageous rates, though not as attractive as those achieved through the loan pool.

Alternatively, and following the housing model, participating banks could set up a nonprofit institute, or contract with an existing and appropriate housing and/or community group to administer the program, to provide guidance and technical assistance to consumers and to act as a conduit for the bank's funds. This has two advantages. One, it provides types of assistance that banks probably cannot, and provides it in a setting comfortable to the consumer. Two, to the extent banks desire it, it provides some insulation by establishing an arms-length relationship should any negative consequences emerge; however this would reduce the learning and awareness about energy conservation that banks need for the future.

Banks that have attempted loan pool arrangements and had positive results could be a target for promoting such programs. For example, several San Francisco banks have provided successful rehabilitation and refinancing funds through a nonprofit housing institute.

Demonstration Program: Integrated Marketing

Brief Description: Banks could join with other parties (hardware manufacturers, insulation contractors, remodellers, etc.) to develop collaborative methods for promoting and delivering conservation products to consumers.

Rationale

If national energy goals are to be met consumers must become convinced of the necessity for conservation and of its benefits. Once convinced, consumers must find easy access to an understandable set of conservation products and services. At the present time each group designs its own products or services to suit its own criteria, advertises and markets these products and services independently, installs the products in a variety of ways using different people, and distributes the hardware through uncoordinated wholesale and retail outlets. Even financing of products is generally done independently of either producer or retailer.

The result is doubly damaging to national energy conservation goals. First, even consumers who begin to understand the value of conservation find it virtually impossible to get in one place advice on problems, an understanding of the range of solutions, listings and adequate descriptions of appropriate products, or help in the process of purchasing, installing and financing conservation hardware. Second, because of the fragmented, uncoordinated "conservation system," consumers have no clear picture of "conservation" as an idea, or as a linked, compatible, mutually-reinforcing group of products, much less as an industry or service.

Integrated marketing and promotion could begin to present a clearer image of conservation to the consumer and synergise the efforts of the multiple actors to the benefit of both consumers and suppliers.

Implementation

"One-stop shopping" for conservation could be approached in several ways. Hardware/do-it-yourself chains could join manufacturers and local banks to promote conservation hardware through "conservation centers." These would offer a wide range of products by different manufacturers allowing comparison shopping; tools and equipment and trained staff advisors could be available for purchase or rent for "do-it-yourselfers"; for non do-it-yourselfers lists could be made available of qualified contractors; financing could be made available either through the retailer, participating banks, or contractors. Supporting this could be instructional and educational materials, samples, technical assistance, discounted offers, and advertising and promotional campaigns. Another model is the "conservation store" recently opened in San Raphael, California, which arrays under one roof solar and wind power energy systems, a range of compatible conservation products, as well as many water conserving devices. This is backed up by assistance, a bookstore library area and informational materials and sources.

Specific integrated marketing and delivery projects would be designed to suit local circumstances. On a regional basis, conservation advisory boards would be set up to do "umbrella marketing" of conservation products and services. The model for this is the "dairy products advisory board" concept which unites the efforts of a variety of product lines in one marketing/awareness message. Such an advisory group could devise promotional themes, do consumer research and make efforts to give conservation a more exciting image (for example, labelling and names for products). Leadership to initiate this idea could be taken by a single group. For example, the American Bankers Association or the U.S. Savings and Loan League could take the lead. The American Bankers Association (ABA) could choose a regional chapter to initiate contacts with other groups in their area, such as the National Association of Manufacturers, and the National Association of Homebuilders. ERDA could develop this concept in more detail, then sponsor a conference or seminar of leading trade groups to explore the idea, and to suggest practical strategies for making it operational.

Demonstration Program: Large Group Marketing

Brief Description: Banks could offer attractive financing to low-risk consumers who are employed by large corporations or institutions -- insurance companies, phone companies, government agencies -- who could also participate in the administration of the program through payroll deductions, educational campaigns, etc.

Rationale

Banks can offer attractive incentives in financing if the costs of the operations involved in the loan procedures are reduced, simplified or eliminated. Large corporations offer several opportunities to achieve these aims and at the same time involve a significant number of consumers in purchasing conservation hardware. The company itself could benefit by good public relations, the bank could develop a profitable program, and the consumer could have access to lower cost financing. Corporations of almost any size could participate, however companies with several thousand employees -- large insurance companies, large engineering firms -- would be logical participants.

Implementation

The bank could offer low interest loans and/or credit card services to participating employers. The employer could undertake educational/informational activities to stimulate employee conservation awareness. This campaign could be tied into a major corporate campaign to reduce energy use in the company's buildings and/or operations, and could use brochures, lunch time speakers, etc. The availability of easy, attractive financing through participating banks would be advertised through inter-office memos, bulletin boards and in-house company newspapers. Payroll deduction of the repayment of such conservation loans could be a convenient feature of the program, set up through a special corporate group that would coordinate and administer the effort. This group could do credit checking, preliminary application for loans, set up payroll deductions and provide liaison with the bank loan department. Specially favorable terms might be offered to those companies who place their payroll deposits with the bank (compensating balances). This is not only a source of loan funds for the bank, but could be a source of new individual accounts, since employees often choose to open checking accounts at the bank that issues their payroll check.

As a test of this idea, such a program could be offered by large banks themselves, especially bank holding companies. This would have several benefits -- it would allow the bank to pilot the idea, test informational materials, user response, etc., in its own, more controlled, environment; it would give the program credibility with potential user corporations, allowing them to see it in action before they participate, and demonstrate a genuine interest in conservation by the bank. It would also provide the bank with useful materials for other energy conservation marketing efforts and for general public relations purposes ("First National, the bank that puts its money where its mouth is").

Demonstration Program: The Bank Energy Center

Brief Description: Banks could set up a highly visible "energy center" to focus the bank's activities in the energy area and to provide a comprehensive group of services to the customer.

Rationale

Decisions about energy conservation investments can involve, or be influenced by, realtors, builders, auto dealers and auto service personnel, homeowner insurance agents, appraisers, building code inspectors, bankers, utilities, manufacturers of appliances and magazines and newspapers. This reflects the pervasiveness of energy in our everyday life. Yet the services offered to deal with the consumers' problems in energy conservation are fragmented and often incomplete. An "energy center" in the bank could provide a focal point for customers by, on the one hand, coordinating bank services, procedures and programs and on the other hand, providing reliable linkages with other actors who can influence consumer decisions. In addition, from the bank's viewpoint, it provides a good marketing theme, but more importantly, could grow into an interdepartmental unit, responsible for coordinating and developing the wide range of energy expertise that will increasingly be required as a part of bank operations.

Implementation

The "energy center" would be set up in the loan department and would include responsibility for auto loans, personal loans, home improvement loans and mortgages for energy conservation purposes or with conservation features. The bank personnel who run the center and administer the programs would undertake a short, intensive course of training in energy issues covering areas of policy and program design, but weighted toward practical problems (choosing insulation, diagnosing energy use, reading/interpreting utility bills, etc.) The program would work to set up relationships between other areas of the bank -- appraisals, loan collections or delinquency -- to ensure, for instance, the appraisers look at the energy features of a house and the monthly utility bill in calculating its value or that when counseling homeowners in difficulty with mortgage payments bank personnel know to look at utility costs as a contributor to delinquency and what can be done to lower them. Contacts can be made with realtors to familiarize them with bank energy conservation financing programs, with builders and remodellers and with insurance agents. Bank personnel would be familiar with the energy-related provisions of state and local building codes and zoning ordinances, as well as the wide range of governmental financial incentives available (tax credits, low interest loans) at both the federal and state level. They could also keep listings of solar heating equipment manufacturers and distributors and have on display informational materials, sample products and promotions of the full range of bank energy conservation financing services.

The energy center in the short run provides a convenient, highly visible access point for the consumer. In the longer term, it could also be the nucleus for the development of the kind of in-house energy expertise that could cross departmental boundaries and assist in the many decisions that banks make that have energy implications.

10. WHAT WILL IT TAKE TO GET BANKS TO DO MORE; AND WHAT SHOULD ERDA'S ROLE BE?

GIVEN THE NATURE OF BANKING AND THE QUESTIONABLE STATE OF CURRENT CONSUMER DEMAND FOR CONSERVATION, BANKS ARE UNLIKELY TO DO A GREAT DEAL WITHOUT OUTSIDE ASSISTANCE AND ENCOURAGEMENT. ERDA, WORKING WITH INDIVIDUAL BANKS AND KEY INDUSTRY CHANNELS (FOR EXAMPLE, THE BANK MARKETING ASSOCIATION, THE AMERICAN BANKERS ASSOCIATION, AND THEIR STATE COUNTERPARTS), SHOULD PROVIDE SUCH ASSISTANCE.

There are three factors which could increase the level of interest banks currently show in energy conservation programs:

1. Increased consumer demand - Energy prices could reach the threshold of financial pain for most homeowners and renters, motivating them to invest in counter measures like conservation investments. Current energy prices, while increasing at unprecedented rates, are still apparently tolerable to most dwellers. It is unclear how much, and how quickly, prices would have to rise before triggering major consumer demand for conservation hardware.

Energy supplies could become seriously threatened, through climatic or geopolitical events, forcing consumers to reduce energy usage, regardless of price. For example, events like last winter's fuel shortage in the Mid-Atlantic states or the potential lack of electrical power stemming from droughts in the western states should increase consumer awareness of, and interest in, conservation measures.

2. Regulatory pressure - Federal or state governments could "create" a market, by making energy conservation measures mandatory or offering significant public incentives. For example, government could require all homes to be adequately insulated before title could be transferred (as was proposed in a bill defeated in the California legislature last year); or that homes satisfy government-set energy efficiency standards within a specified time period; or it could make conservation features a prerequisite for receiving federal or state funding (loans, grants, etc., to either individuals, or local governments for such programs as neighborhood preservation). This would change totally the nature of the role of financing mechanisms, from one of fostering market demand, to one of facilitating compliance with government dictates.

To the extent that government policymakers are convinced that consumer demand for conservation items is being artificially repressed by lack of sufficient or attractive financing, government could require banks and other financial institutions to set aside a predetermined percentage of their available loan funds for energy conservation purposes. This type of mandatory strategy could be coupled with governmentally subsidized low interest loans, or loan guarantees to induce lenders to offer favorable financing to interested consumers. The first strategy has frequently been suggested to ensure adequate funds for residential mortgages, but has never been implemented; the second, while implemented in other areas such as student loan programs, has had a less than enthusiastic reception from lending institutions.

3. Industry encouragement and assistance, perhaps with government support - In the absence of significant increased consumer demand or intensified regulatory pressures, as outlined above, widespread individually-initiated bank programs are unlikely to be forthcoming without outside assistance and support from the banking industry and/or government agencies. While the short-term opportunities for purely voluntary bank action are relatively modest and undramatic, they are not unimportant. Banks can act now to support the renewed national emphasis on conservation as a central aspect of energy policy. A government strategy focused on the design of exotic, wholly new financing instruments which will likely face significant resistance within the banking industry offers much less promise than an approach based on pragmatism, stressing the application to conservation purposes of existing mechanisms, familiar to both bank and consumer.

There are several ways that the federal government, and ERDA in particular, can encourage banks to play a more aggressive role in stimulating residential energy conservation. For the near term, the government should pursue three basic strategies to involve commercial banks in energy conservation now, and build a base of available financing programs to accommodate possible future increases in consumer demand for conservation items.

Given the pattern of innovation within the banking industry and the traditional ambivalence with which banks view government involvement in bank operations, the principal responsibility for implementing these strategies should rest within the industry itself. ERDA's role, while critical in the early stages, should primarily be that of catalyst and facilitator, providing limited seed money, technical assistance and advice, and supporting research as neces y

Three Recommended Strategies

- First, creatively package summaries and evaluations of prior bank conservation programs and descriptions of promising ideas for new programs; aggressively disseminate that material through banking industry organizations and publications, to make it easier to improve program design based on prior experience of their counterparts elsewhere.
- Second, expand market coverage of bank conservation programs by demonstrating alternative program strategies in as many locations as possible. At a minimum, the government should seek to have at least one Seattle Trust-type favorable rate loan program in every major market setting in the country within the next two years. The availability of such straightforward, convenient programs should ensure that as consumer demand for conservation hardware grows, financing does not become a bottleneck to widespread investment in conservation measures. In addition, there are specific opportunities to go beyond the Seattle Trust-type program in developing and demonstrating alternative roles which banks might play to encourage conservation investments. Selection of locations for all program demonstrations should reflect the size of the markets which could be reached, a representative geographical distribution, and take advantage of particular opportunities or events which promise unusually high bank and consumer interest in conservation activities.
- Third, begin building a conservation constituency within the banking industry so that bank conservation programs and concepts become more visible and legitimate to bankers throughout the country. This should involve working with key representatives of national and state banking trade associations and publications, as well as contacts with particularly innovative individual banks which have embarked upon provocative conservation programs. In addition, relationships should be created between banking industry groups and other major industries concerned with conservation, most importantly utility companies, manufacturers and distributors of conservation hardware, and home improvement contractors and installers. Such a constituency could assume responsibility for carrying out an "umbrella" marketing effort to support local conservation activities, as well as developing necessary support materials, consumer literature, advertising copy, and the like for banks and others to use in their programs.

The strategies outlined above are described in greater detail in the following section.

STRATEGY ONE: CREATIVE PACKAGING AND DISSEMINATION

RATIONALE:

In the short term there is a pressing need to inform banks about energy conservation as a national problem, and familiarize them with conservation as a new program opportunity. Most bankers are not knowledgeable about energy problems in general or energy conservation in particular. They do not understand the place of conservation within overall energy policy, may not be familiar with conservation hardware -- what it costs, what it does, how it's installed -- and are probably unaware of the multiple motivations of consumers or how that could be translated into effective bank marketing messages. Within banks, specialist experts develop in areas in which banks lend money -- in real estate, transportation, etc. -- but there are as yet no industry energy conservation experts to design programs that fit conservation issues into regular product lines (e.g., incorporating energy costs into the traditional formula of evaluating real estate mortgages) or to develop new program ideas and bank-wide strategies.

In addition, there are few sources to which bankers can quickly turn for such advice or technical assistance. Trade publications cover energy rather superficially. In our survey of state banking associations, only a handful had studied the conservation program efforts of its members or attempted to set up any kind of clearinghouse to facilitate such activities.

A strategy of creative packaging of energy conservation information and the establishment of a convenient dissemination system would improve understanding of energy conservation within the industry and foster wider participation by banks.

TACTICS:

(1) "The Bankers Energy Conservation Kit(s)"

Bankers Conservation Kits would be tailored to fit the characteristics of various types of banks. These kits would contain "core" information helpful to all banks -- background studies, data sources, contacts in trade associations, state energy agencies, private groups, etc.; case studies, examples of available brochures and explanatory

materials (such as the HUD pamphlet, "In the Bank Or Up The Chimney"). This material would be supplemented by descriptions of specific program options, marketing strategies for particular target audiences, advertising concepts, and sample ads ("Put Batts In Your Belfry"), prototype television and radio commercials, program formats and support materials (application forms, energy audit materials, approved hardware lists, etc.).

Banks, like consumers, can be grouped according to their size (assets and locations), operating characteristics, and interest in innovation. For the purposes of designing the Bankers Kits, banks could be divided into three groups:

- The "passive" bank -- not noted for its innovativeness; traditional and conservative in philosophy and management; modest advertising and marketing; follows the industry and adopts new ideas only when they have been tested by others and shown to be viable; interested in conservation only as an issue of corporate social responsibility and a public relations opportunity rather than a business area.
- The "active" bank -- likes to keep up with what the industry trail blazers are doing, but is still cautious about taking "unnecessary" risks; may be interested in experimenting with special conservation programs featuring rate or term variations.
- The "aggressive" bank -- not necessarily the large bank, this kind of bank is the "lighthouse" or "pioneer", pursuing new opportunities, marketing services forcefully, ready to innovate; may be interested in developing a bank-wide strategy including special marketing, new programs, and integrated offerings with other energy conservation system participants like utilities, installers, and retailers.

(2) "Circuit Riding Workshops"

Many bankers have commented that a principal dissemination method of ideas in the commercial banking field is through workshops and seminars. In fact, some banks that have developed new programs have actually recovered part of their costs of designing and implementing the program by holding "how-to-do-it" workshops for other banks.

The "Circuit Riding Workshops" would be regional seminars and workshops conducted principally, but not exclusively, for bank officials. They would be designed to provide a forum for presentation of energy issues, discussion of energy conservation and its impact on financial institutions; to explore strategies available to banks in becoming involved in conservation; facilitate exchange of ideas and experiences between individual banks; present "how-we-did-it" case examples by pioneering banks; provide an opportunity for giving advice and specific technical assistance to banks initiating conservation programs; disseminate energy conservation materials (magazine reprints, brochures, pamphlets, new research findings, new product descriptions, etc.) and the "Bankers Energy Conservation Kit." Each workshop would have a carefully planned program to cover a wide range of bank industry interests in energy conservation with possible sub-sessions to cover topics of particular local concern. The workshop provides an excellent opportunity to link into existing networks of advice and technical assistance (statewide municipal leagues, for example) and to new programs such as the ERDA Energy Extension Service.

The one-day workshops would be organized and run by a small 3-4 person traveling "core team." The team would have experts in energy conservation, program design and implementation, banking and bank practices, and could be supplemented in each location by local resources, especially in related fields such as home improvements, utility operations, etc. The circuit riding workshops would be under multiple sponsorship, and could be organized at the state level or the national level.

STRATEGY TWO: EXPAND MARKET COVERAGE OF BANK PROGRAMS

RATIONALE: It is likely that consumer demand for energy conservation measures will increase in the next few years, either rapidly in response to emergency situations or government regulation, or gradually as prices rise and supplies diminish. As the demand emerges it is important that consumer acquisition of conservation items not be hampered or constrained by the lack of available, convenient financing mechanisms.

Available consumer research suggests that interest in conservation is, at best, episodic and short-lived. As might be expected, bank interest has by and large paralleled the interest levels of the consumers, its customers. During emergencies or crises (like the 1973 gas shortage or this winter's cold spell), consumer awareness and interest in energy conservation is high. However, while awareness remains, interest falls off very rapidly as conditions stabilize or the crisis abates. For the government to capitalize on this high, but temporary, level of interest requires that conservation financing mechanisms either be in place or be easily mobilized to coincide with peak consumer demand.

TACTICS: (1) Replication of "model" programs in key market areas

As in most businesses, banks learn from each other. They appear to share information fairly widely; and banks with industry reputations as innovators are frequently copied. This is especially true at the regional level, reflecting differences in state banking regulations, varying industry traditions, and the types of customers that banks serve.

At a minimum, therefore, within the next two years the government should seek to promote the wide-spread development of straightforward, well-marketed energy conservation programs, similar to the Seattle Savings and Trust program (which offers special rates on auto, home improvement, and residential mortgage loans that satisfy predetermined energy conservation criteria). A comparable program in each major bank market area would ensure that consumers have access to at least one outlet for favorably financing their conservation investments, and would have the effect of encouraging other banks to explore and implement conservation programs, by providing highly visible "models."

(2) Capitalize on events -- opportunistic intervention

In concert with this deliberate strategy of establishing programs in every major market area of the country, ERDA should also pursue a more opportunistic approach, capitalizing on consumer and bank interest by having available a service to banks that would enable them to mount energy conservation programs on short notice in crisis situations.

For such "opportunistic" strategies to work, at least two basic components are required. The first is a "market monitoring" system. Crises are both national and, more frequently, regional. Within ERDA or FEA, regional responsibilities should be assigned to track energy-related developments and anticipate events that could trigger consumer interest. In fact, many critical events can be predicted or anticipated even though they come to the public consciousness as apparent natural disasters. For example, severe problems with electrical generating capacity can be foreseen in the West this summer due to drought conditions and lack of snow. Fuel price hikes can often be anticipated, as can fuel shortages or new legislation. Some things are harder to predict, like this winter's impact on the Mid-Atlantic states. A regional market monitoring system -- the "California Desk" to use a State Department analogy -- would allow early identification of these events and pre-planning of ERDA program responses.

Second, when a dramatic event is anticipated or a crisis erupts, the government should have trained personnel ready to help banks and others respond effectively. The model here would be the disaster relief teams of the federal government: highly skilled program facilitators who could move into a crisis area and commence at once to offer information, support materials, and intensive training and technical assistance to banks to set up appropriate programs.

(3) Develop "trail blazer" programs

The bank energy conservation programs developed to date have been initiated by individual banks acting alone, and have largely been limited to variations on the standard bank product line (special interest rates or terms and the like). Opportunities exist to develop new program concepts that build upon the multiple vested interests in the energy conservation "system" -- utilities, home improvement contractors, etc. Several of these new program concepts have been discussed in the previous chapter.

STRATEGY THREE; CONSTITUENCY BUILDING

RATIONALE:

At the present time, energy conservation lacks a constituency and effective champion within the financial community. Banks are largely unaware of the implications for them, in both the short and long term, of the adoption of a national energy policy in which conservation would be a central aspect.

Without a solid constituency within the industry it will be extremely difficult to generate programs much beyond the rather random, scattered initiatives that have occurred in the past. Equally, there is no energy conservation "industry" as such that would provide a context for action on the part of all the organizations and firms that provide goods or services which relate to energy conservation. There is, at present, little communication between manufacturers, installers, retailers, lenders, utilities, and public agencies. Each has some vested interest in energy conservation; each has skills and resources that relate to the problems; yet there has been little effort to take advantage of the combined financial, operational, and marketing resources represented by these groups. These activities provide a backdrop against which the two principal strategies can be developed.

TACTICS:

- (1) "Consciousness Raising" in the financial industry

Constituency building is inherently a long term and gradual process around an issue as unfamiliar as energy conservation. Such activities include:

- Creation of task forces within the industry, to develop banking industry policy toward conservation, in areas such as:
 - technical innovation
 - regulation and legislation
 - technical assistance
 - research and development
 - publicity and promotion
 - corporate responsibility

- Sponsorship of articles in newspapers and trade publications. The articles would stress specific bank experiences, motivation for getting into energy conservation programs and their results.
 - Promotion of energy conservation through offering of speakers and panelists at trade association conventions, regional workshops and individual bank functions.
 - Encouragement of supportive statements by industry leaders; public announcements of the initiation of new programs by leading banks.
- (2) Reward innovative leadership in energy conservation

ERDA should develop and publicize a program of public recognition and awards for individuals and banks who make a special contribution to energy conservation efforts. This could take the form of the "ERDA Award for Conservation Leadership," or "The President's Citation for Energy Leadership."