FEDERAL FINANCIAL INCENTIVES: NEW APPROACHES

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OVERVIEW

- **Nature of the Problem**
  - Financial Challenges to Meet 20% Wind Scenario
  - Expired Federal Financial Incentives
  - Need to Diversify Financial Incentives

- **Approaches That Do Not Require Legislation**
  - Real Estate Investment Trusts (REITs)
  - Bond Financing

- **Approaches That Require New Legislation**
  - Master Limited Partnerships (MLPs)
  - Federal Clean Energy Standard
  - State or Local Feed-in Tariffs
FINANCIAL CHALLENGES TO MEET 20% WIND SCENARIO

U.S. Is on a Trajectory that May Lead to 20% of Electricity Coming from Wind

But ramping up further to ~16 GW/year and maintaining that pace for a decade is an enormous challenge, and is far from pre-determined
**Ca$h Grant in Lieu of ITC** - enacted Feb. 2009 & extended Dec. 2010 – Sec. 1603 of the American Recovery and Reinvestment Act

- Of approx. 17 tax equity investors active in major RE financings during 2007, only 7 were active in 2009.
- 30% cash grant equal to 30% of cost of energy property in lieu of the Investment Tax Credit (including ITC claimed in lieu of the PTC);
- Treasury Dept. must pay eligible grantees within 60 days of application;
- **Current Limitations:**
  - Qualifying energy property placed in service prior to Dec. 31, 2011; or
  - Qualifying energy property placed in service after Dec. 31, 2011 as long as facility construction begins prior to Dec. 31, 2011; and qualifying property must be placed in service prior to the expiration date of the applicable tax credit.
IMPACT OF EXPIRATION OF CA$H GRANT PROGRAM

Last year’s US PREF tax equity study estimated there would be ~$3.0 billion of tax equity available in the market place through the end of 2010 – by the end of 2010 ~$3.3 billion of tax equity was deployed.

Last year’s study estimated there would be ~$3.0 billion in a normal market of tax equity available in 2011 – year-to-date $1.9 billion in tax equity has been deployed, this study estimates by year end 2011 there may be ~$3.6 billion of total tax equity.

Sources: U.S. Department of the Treasury, US PREF Estimates, Leading Tax Equity Market Participants

(1) Includes all 1603 Treasury Grants for renewable projects

(2) Projects with 5% equity spend or in continuous construction prior to 12/31/2011 and that achieve CDD by 12/31/2012 are eligible for the Section 1603 cash grant.
See Interview of Denny McGinn, President of ACORE, Platt’s Energy Week, June 17, 2012

“Need to diversify” from primary reliance on tax equity for financing renewable energy projects;

The renewable industry is seeking to broaden sources of capital and to lower costs of capital.

http://www.plattsenergyweeektv.com
REAL ESTATE INVESTMENT TRUSTS (REITs)

- Source of financing for real estate assets for more than 50 years;
- Breakthrough in potential use of REITs for electric transmission and associated assets - IRS ruling in 2010;
- Not subject to the 35% Federal corporate income tax on REIT income distributed to shareholders
  - But REIT must distribute 90% of its taxable income each year;
Benefits of REITs compared to the PTC
- Broader investor base – U.S. retail investors, U.S. tax-exempt investors, foreign portfolio investors;

Series of asset tests describe the types of property that REITs may own:
- Wind towers, pads, real estate likely to qualify.
- Turbines, blades, and nacelles will not qualify.

REITs might be used more to provide capital for projects coming off tax credits vs. new projects;

The bond market can help compensate for shortfalls in wind energy financing;

Since 2008, the share of bond financing for RE projects has increased relative to bank financing;

Bond financing used in conjunction with bank financing for Caithness Shepherds Flat Wind Project – 845 MW in Oregon

- Largest wind energy project in the world, once completed.
MLP - business structure taxed as a partnership but ownership interests are traded like corporate stock;

Nearly 30 years - Federal tax code only authorized formation of MLPs to investors in energy portfolios for “depletable” resources, such as oil, natural gas, and coal (IRC sec. 7704);

June 7, 2012 - Sen. Coons (D-DE) and Sen. Moran (R-KN) introduced the MLP Parity Act (S. 3275), which creates a level playing field by allowing investors in renewable energy portfolios, including wind energy projects, to form MLPs;
MLPs carry the fund-raising advantages of a corporation: ownership interests are publicly traded and offer investors the liquidity, limited liability, and dividends of classic corporations;

Limitations of MLPs – Not attractive to tax-exempt entities and foreign investors;

The MLP Parity Act is supported by the American Wind Energy Association, the Offshore Wind Development Coalition, the Natural Resources Defense Council, and others.
FEDERAL CLEAN ENERGY STANDARD (CES)

- **Major Proposal** – S. 2146 – Sen. Bingaman

- **Comparison to Federal Renewable Portfolio Standard**

- **Examples of Key Design Issues**
  - Definition of clean energy – e.g., “efficient” natural gas, energy efficiency?
  - Minimum requirement(s) for specific types of energy sources – e.g., renewable energy?
  - Relationship to State RPS laws;
  - Credit for new vs. existing projects?
  - Requirements and timetables;
  - Financial penalties for noncompliance.
STATE OR LOCAL FEED-IN TARIFFS

- Most successful and most common form of renewable energy incentive in the world (though Spanish experience shows design details are critical);
- Provides a guaranteed payment (e.g., cents/kWh) for the full output of the system for a guaranteed period of time (typically 15-20 yrs.);
- Payment guarantee often accompanied by guaranteed access to the grid.
National U.S. FIT legislation (HR 5883) introduced by Rep. Inslee in 2010 but enactment highly unlikely

However, several States and municipalities have adopted FITs
- e.g. VT, CA, Gainesville, FL;
- Other States are considering action.