Your project generates Investment Tax Credits but you have no US tax liability. Now what?
Agenda

• About Ernst & Young
• Tax Credit Monetization Basics
• Quick look at the two most common monetization structures
  – Partnership Flip
  – Sale Leaseback
• Investor Hot Button Issues
• Case Study
Ernst & Young LLP

• Ernst & Young is one of the largest professional service firms in the world. Its 130,000 professionals in 140 countries provide a range of services, including accounting and auditing, tax reporting and operations, tax advisory, and human capital services.

• U.S. Renewable Energy Service Lines
  – Cleantech Network
  – Energy Efficiency Tax Incentives
  – State and Local Tax Incentives
  – Washington Council Ernst & Young
  – Tax Credit Investment Advisory Services

• Renewable Energy Group (Global)
Tax Credit Monetization

• The federal tax credits can not be sold like a good
• The federal tax credits represent a huge capital subsidy which should either be claimed against current tax or monetized:
  – Credits are monetized by bringing outside investors into the financing of your project using a pass-through entity and the tax credits are allocated in accordance with ownership percentages
  – The allocation of energy credits from a project owner that cannot use them, to an institutional investor that can, provides the least expensive available source of capital for project financing
Partnership Flip Structure
Partnership Flip Structure Basics

- An Operating Partnership consists of a Limited Partner and General Partner
- Tax Credit Investor’s contribution is based upon their share of the projected returns
  - Cash from Operations
  - Tax Credits
  - Tax Deductions from Depreciation
  - State Incentives
  - Residual
Partnership Flip Structure Basics

- In Year 1: 95% of:
  - Cash Flow from Operations
  - Federal Tax Credits
  - Depreciation
  - State Incentives

will flow to the Tax Credit Investor
Partnership Flip Structure Basics

- In the year in which the Tax Credit Investor achieves its targeted rate of return (agreed upon prior to entering the partnership), the ownership allocations “flip” (change) to a predetermined percentage.
- Upon the occurrence of the flip, the Developer would have an option to buy the Tax Credit Investor’s interest (post-flip percentage) at Fair Market Value.
Sale Leaseback Structure
**Sale Leaseback Basics**

- The Developer sells the solar equipment to the Tax Credit Investor at a retail price.
- The Tax Credit Investor in turn leases the panels back to the Developer.
- As owner of the equipment, the Tax Credit Investor is entitled to:
  - Federal Tax Credits
  - Certain State Incentives
  - Tax Deductions from Depreciation
  - Predetermined Lease Payments
- The Tax Credit Investor will put up 100% of the capital and the lease payments will vary to ensure the Tax Credit Investor’s return.
Sale Leaseback Basics

- The developer responsible for installation, maintenance, etc
- The developer sells the electricity to the utility
- Lease payments need to be made whether or not the solar equipment generates sufficient income
- Typically, at the end of the lease, the developer has the option to buy the equipment at Fair Market Value or to extend the lease
Investor Hot Button Issues
Investor Concerns

• Are they being compensated for the risks they are being asked to take?
  – Tax risk
  – Technology risk
  – Corporate risk
  – Electricity pricing risk

• What is the risk of lost benefits due to foreclosure?

• How safe is the back-end?

• What else is going on in the tax credit investment world?
  – LIHTC
  – Wind

• How else can we work together?
Case Study
## Case Study

<table>
<thead>
<tr>
<th>Structure A: Basic Partnership Flip</th>
<th>Structure B: Partnership Flip Minimizing Repurchase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financing Structure</strong></td>
<td><strong>Cash Flow Distributions Until Repurchase</strong></td>
</tr>
<tr>
<td>Debt: 24%</td>
<td>Sponsor: 3%</td>
</tr>
<tr>
<td>Tax Equity: 76%</td>
<td>Tax Equity: 53%</td>
</tr>
<tr>
<td><strong>Sponsor Repurchase</strong></td>
<td><strong>Typical Sponsor Profile</strong></td>
</tr>
<tr>
<td>Debt: 44%</td>
<td>Equipment manufacturer with limited capital resources.</td>
</tr>
<tr>
<td>Sponsor: 3%</td>
<td>Equipment manufacturer with lower cost of capital than the tax equity’s required yield.</td>
</tr>
<tr>
<td><strong>Typical Sponsor Profile</strong></td>
<td></td>
</tr>
<tr>
<td>Equipment manufacturer with limited capital resources.</td>
<td></td>
</tr>
</tbody>
</table>
# Case Study

## Structure C: Partnership Flip to Early Repurchase

<table>
<thead>
<tr>
<th>Financing Structure</th>
<th>Cash Flow Distributions Until Repurchase</th>
<th>Sponsor Repurchase</th>
<th>Typical Sponsor Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity: 6%</td>
<td>Sponsor: 0.5%</td>
<td>6y 10y 15y 20y 26y</td>
<td>Equipment manufacturer or other intermediary who wants full access to the asset as quickly as possible.</td>
</tr>
<tr>
<td>Debt: 31%</td>
<td>Tax Equity: 39%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Equity: 63%</td>
<td>Debt Equity: 60.5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Structure D: Lease Structure

<table>
<thead>
<tr>
<th>Financing Structure</th>
<th>Cash Flow Distributions Until Repurchase</th>
<th>Sponsor Repurchase</th>
<th>Typical Sponsor Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Equity: 100%</td>
<td>Sponsor: 100%</td>
<td></td>
<td>Credit-worthy intermediary who is speculating on the price of energy.</td>
</tr>
</tbody>
</table>

*Sponsor pays 5% of project costs annually to tax credit equity*
Conclusion

• Tax credit monetization structures have a lot of “levers” that can be adjusted to structure the project to best fit your needs…
  – Cash Flow
  – Capital Budgeting
  – Book Recognition
  – Desire to Control the Asset
  – Risk Sharing

• Levers
  – Pre-flip Allocations
  – Post-flip Allocations
  – Target Flip Date
  – Project Leverage
  – Back Leverage
  – Preferred Allocations
  – Lease Structure
  – Deferred Development Fees

• Variables
  – PPA Structure
  – State Incentives
Conclusion: Transaction Comparison

- The Partnership Flip structure provides the most flexibility
- The Sale Leaseback requires the least amount of up-front capital

- Partnership Flip structure shares the operational and performance risk - as if the equipment under performs the allocation flip occurs later and if the equipment over performs then the flip occurs earlier
- Under the Sale Leaseback structure, the developer has all the operational upside and downside - as if the solar equipment over performs, more cash is generated and if the solar equipment under performs, less cash is generated - but in both circumstances they will have the same lease payments.

- Under the Partnership Flip structure, the developer will have no future mandatory payments and under the Sale Leaseback structure, the developer will have mandatory payments until the expiration of the lease

- If a Partnership Flip structure is used, the term of the Power Purchase Agreement will need to be as long as the Tax Credit Investor’s projected pre-flip period
- If merchant pricing is utilized (either full or partial), then typically a sale leaseback structure is more appropriate
Conclusion

- There are two messages that you should take away from the case study:
  - That there are various ways to structure the same transaction, which offers the Tax Credit Investor the same return, the developer should make sure that they are using the best structure that suits their needs.
  - A Proposal from a Tax Credit Investor which includes the highest up-front capital, or the lowest return for the investor, may not necessarily be the best transaction for the developer.
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