

Novogradac Journal of Tax Credits

News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits

November 2012, Volume III, Issue XI

Published by Novogradac & Company LLP

Renewable Energy Flourishes Despite End of Grant

By Jennifer Hill, Staff Writer, Novogradac & Company LLP

As it begins to feel the effects of the Section 1603 program's expiration, the renewable energy tax equity market is at a critical juncture. Although the grant program expired last December, most developers lined up Section 1603 deals to see them through the better part of this year and delayed the return to traditional tax credits.

"That's going to shift right now," said Dirk Michels, partner at K&L Gates. While there may not be as many investors in the renewables space as there were during the pre-recession economic boom, experts report that both the market and the technology have matured and are continuing to attract significant investment despite the end of the grant program.

A Market in Transition

In the absence of the grant, the growing segmentation of the renewable energy tax equity market has come into focus. Beyond the basic project types of solar, wind, biomass and geothermal, the submarkets of these four mainstream renewable energy technologies have become clearer as the overall clean energy market matures. Some industry participants divide the solar market into the three areas: utility-scale, distributed generation and residential. Others go even further and separate distributed generation deals into utility-scale and non-utility scale.

Solar projects, in both the residential and commercial spaces, are attracting the most tax equity and experts expect this trend to continue into next year as developers wrap up their Section 1603 wind deals. If those investors stay in the market, industry participants expect most of them to turn to solar investment tax credit (ITC) deals, especially considering the uncertainty surrounding the wind production tax credit's (PTC's) extension.

"Most ITC investors have been working hard to get wind deals done, and now they will be turning their attention to solar. There are less of them, so it's safe to say the cost of capital is going up," said Kristian Hanelt, senior vice president of renewable capital markets at Clean Power Finance.

Several investors and attorneys reported seeing yields for unleveraged deals between 7 and 9 percent, and estimated that at their peak, solar ITCs sold for approximately \$1.40 and have since dropped to the \$1.20s and \$1.30s. Investors currently obtain a significant premium for equity that is behind the debt, according to Scott Stevenson, managing director at Bank of America. He also noted that yields have remained fairly constant.

Residential and commercial solar portfolios are drawing the most investment, said Jim Duffy, partner at Nixon Peabody LLP. Jim Howard, CEO of Dudley Ventures, and Duffy both noted that because of lower power purchase agreement (PPA) pricing, larger utility-scale deals are more difficult to pencil out. However, institutional investors said that the transactional efficiency of smaller utility-scale projects still makes them attractive investments. Several experts predicted the most growth to occur in the residential solar space.

The exact number of investors in the renewable energy tax credit is uncertain; most industry participants estimated the number of investors to be between 10 and 20, and some said it could be as high as 30. Some of the most active and well-known investors include PNC Bank, Citibank, Wells Fargo, US Bank and Bank of America. Bank of America will invest close to \$1 billion in renewable energy deals this year, a 30

continued on page 2

continued from page 1

percent increase over 2011, and expects to increase its investment again next year, according to Todd Karas, a managing director at Bank of America. Newer players like Rabobank are also ramping up their renewable energy investments, said David Burton, partner at Akin Gump Strauss Hauer & Feld.

"Investors have a lot of leverage right now because there aren't many. It's a buyer's market, so they can pick and choose the deals and they pick the safest deals," Duffy said. This certainly holds true in the distributed solar market, which participants predict will see some developer consolidation going into 2013. "Only the platforms with the best developers and stories will be able to secure capital," Hanelt said. "It's probably going to force consolidation in the industry as the bar for the quality of the developer to secure capital goes up."

Small but Expanding

Though the pool of energy tax credit investors is small, new investors from outside the financial services sector are beginning to test the waters. "The market is gaining investors and they want to be educated," Michels said. "We've had a number of requests for that, and not from the typical equity investors you'd expect." Several Fortune 500 companies are exploring the possibility of investing in renewable energy, he noted. "They see Google invest and save money, so they say, 'if Google does it, then why can't we do it?'"

Google, an environmentally conscious company with a substantial tax liability, is exactly the type of corporate investor that the market needs, several industry participants noted. The company has invested in both Section 1603 and ITC funds, including a \$75 million residential solar ITC fund with Clean Power Finance. For now, banks and insurance companies continue to dominate the renewable energy tax credit landscape. But Michels and others say this may change as more corporations consider investing in renewable energy projects not just for their own facilities, but in general.

Barriers to Entry

Experts agree that the main obstacle preventing new investors from taking the plunge is the program's complexity. "We continue to gain traction but it's a long process," Howard said of attracting new investors to the market. "Where there's no permanency to the credit, the willingness of investors to put the time in and learn the credit and risks results in some diminishment of interest."

However, experts point out a couple of silver linings. "It takes a long time to get comfortable, but once you dive into it they can all be packaged similarly," Burton said. For solar, now that the industry has established a track record, there are more data points on performance that sponsors can point to when talking

continued on page 3

Novogradac Journal of Tax Credits

Editorial Board

PUBLISHER

Michael J. Novogradac, CPA

MANAGING EDITOR

Alex Ruiz

TECHNICAL EDITORS

Robert S. Thesman, CPA
James R. Kroger, CPA
Owen P. Gray, CPA
Thomas Boccia, CPA
Daniel J. Smith, CPA

ASSIGNMENT EDITOR

Jennifer Dockery

STAFF WRITER

Jennifer Hill

EDITORIAL ASSISTANT

Teresa Garcia

CONTRIBUTING WRITERS

Frank Buss	John Leith-Tetrault
Brian Carnahan	Forrest David Milder
G. Tyler Gibbs	Cyle Reissig
Mike Hannon	John M. Tess
Peter Lawrence	Dirk Wallace

CARTOGRAPHER

David R. Grubman

PRODUCTION

Alexandra Louie
Jesse Barredo
James Matuszak

Novogradac Journal of Tax Credits

Information

Correspondence and editorial submissions:
Alex Ruiz / 415.356.8088

Inquiries regarding advertising opportunities:
Emil Bagalso / 415.356.8037

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding the low-income housing tax credit or any other material covered in this publication can only be obtained from your tax advisor.



NOVOGRADAC
& COMPANY LLP®

CERTIFIED PUBLIC ACCOUNTANTS

© Novogradac & Company LLP
2012 All rights reserved.
ISSN 2152-646X

Reproduction of this publication in whole or in part in any form without written permission from the publisher is prohibited by law.



Novogradac Journal of Tax Credits Advisory Board

LOW-INCOME HOUSING TAX CREDITS

Bud Clarke	BOSTON FINANCIAL INVESTMENT MANAGEMENT
Jana Cohen Barbe	SNR DENTON
Tom Dixon	BOSTON CAPITAL
Rick Edson	HOUSING CAPITAL ADVISORS INC.
Richard Gerwitz	CITI COMMUNITY CAPITAL
Rochelle Lento	DYKEMA GOSSETT PLLC
John Lisella	U.S. BANCORP COMMUNITY DEV. CORP.
Phillip Melton	CENTERLINE CAPITAL GROUP
Thomas Morton	PILLSBURY WINTHROP SHAW PITTMAN LLP
Arnold Schuster	SNR DENTON
Mary Tingenthal	MINNESOTA HOUSING FINANCE AGENCY
Rob Wasserman	U.S. BANCORP COMMUNITY DEV. CORP.

PROPERTY COMPLIANCE

Sharon Jackman	SIG SERVICES LLC
Michael Kotin	KAY KAY REALTY
Michael Snowdon	MCA HOUSING PARTNERS
Gianna Solari	SOLARI ENTERPRISES
Ruth Theobald Probst	THEOPRO COMPLIANCE & CONSULT. INC.
Kimberly Taylor	HOUSING DEVELOPMENT CENTER

HOUSING AND URBAN DEVELOPMENT

Ray Landry	DAVIS-PENN MORTGAGE CO.
Sheldon Schreiber	PEPPER HAMILTON LLP
Monica Sussman	NIXON PEABODY LLP

NEW MARKETS TAX CREDITS

Frank Altman	COMMUNITY REINVESTMENT FUND
Merrill Hoopengardner	ADVANTAGE CAPITAL
Scott Lindquist	SNR DENTON
Matthew Philpott	U.S. BANCORP COMMUNITY DEV. CORP.
Matthew Reilein	JPMORGAN CHASE BANK NA
Ruth Sparrow	FUTURES UNLIMITED LAW PC
Joseph Wesolowski	ENTERPRISE COMMUNITY INVESTMENT INC.

HISTORIC TAX CREDITS

Don Holm	HOLM LAW FIRM
John Leith-Tetrault	NATIONAL TRUST COMM. INVESTMENT CORP.
Bill MacRostie	MACROSTIE HISTORIC ADVISORS LLC

John Tess HERITAGE CONSULTING GROUP

RENEWABLE ENERGY TAX CREDITS

Ben Cook	SOLARCITY CORPORATION
Jim Howard	DUDLEY VENTURES
Forrest Milder	NIXON PEABODY LLP
Darren Van't Hof	U.S. BANCORP COMMUNITY DEV. CORP.

continued from page 2

to prospective investor.

Some are calling for Congress to reform the program and simplify it. John Pimentel, president of Foundation Windpower, noted that the ability to treat renewable energy investments like master limited partnerships (MLPs) would encourage more investment in the market. Allowing MLPs to be used would result in billions of dollars flooding the renewable energy tax equity market, Michels said.

The recent Boardwalk Hall historic rehabilitation tax credit court decision underscored the complexity of the renewable energy tax credit program. Some experts indicate that although the industry should not ignore the landmark decision, it will ultimately have little effect on closing renewable energy deals. "It fundamentally goes to 'what does it really take to be a partner?'" Howard said of the essence of the case, which involved a historic tax credit investment in New Jersey. "The nature of renewable investments is different but the partnership analysis is the same." Duffy said that if a deal's underlying economics are strong, a prospective investor would be unlikely to be dissuaded by Boardwalk Hall concerns.

Outlook for 2013

The top priority for virtually all players in the market, including current investors, is bringing new investors into the fold. Because of the high volume of Section 1603 projects still working their way through the pipeline, they have a limited amount of time – if developers do have to scramble for capital it won't happen until next year, according to industry participants. "The market will continue to grow and want more equity," said Dick Rai, manager at PNC Bank. "The loss of grants in lieu will hurt." The National Renewable Energy Laboratory estimates that \$25 billion in tax equity investment will be needed to meet market demand in 2013, far outstripping the current tax appetite.

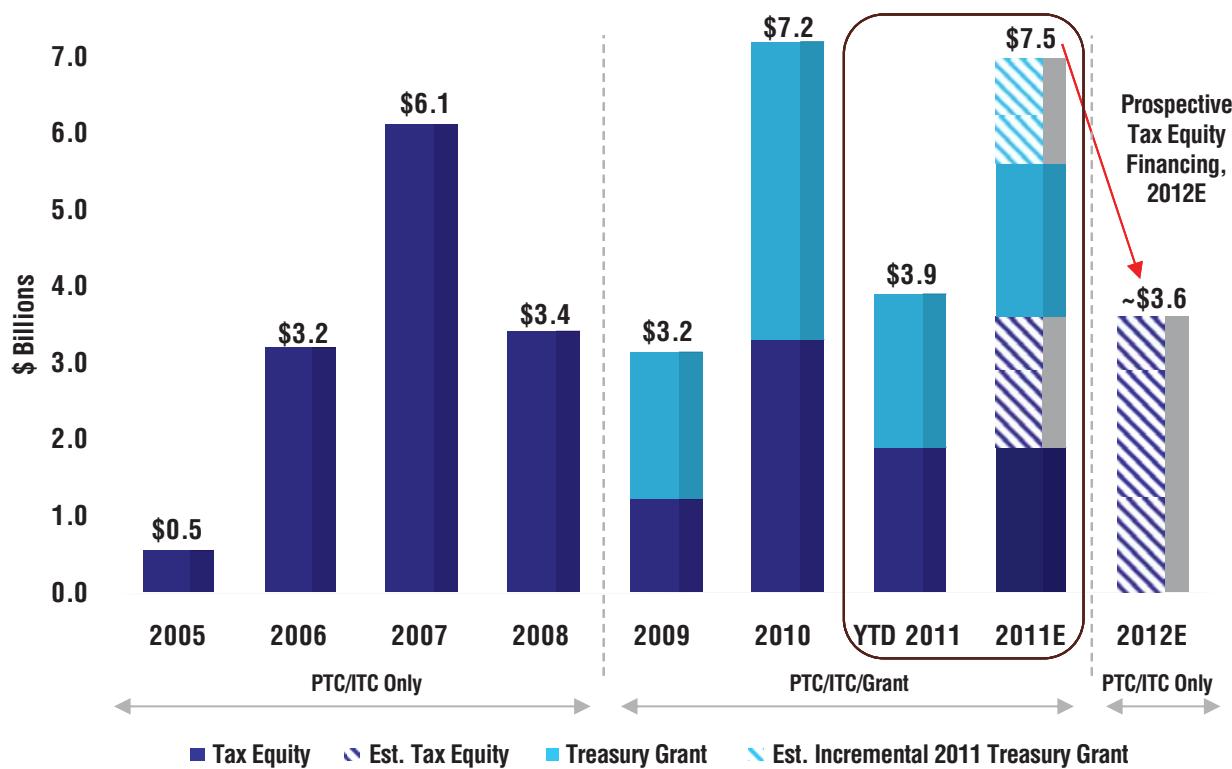
Seasoned developers will need to step it up by making sure their equipment is backed by a tier one manufacturer, and newer players may find themselves teaming up with a more experienced developer to stay in the game. Rai predicted that project originators, as opposed to true developers, who have been able to source deals and pull together PPAs under the grant environment may have a harder time finding their place in next year's ITC/PTC market, which he said will require more sophistication to navigate.

A tax equity scarcity next year would also dictate the types of projects completed. "If Section 1603 goes away and there's not enough equity or debt to do all the projects, only the economically less risky deals will get done," Duffy said. "You might not see the creative, community-oriented deals." ♦

continued on page 4

continued from page 3

Historical Tax Equity and Treasury Grant Financing, 2005 – 2011E (last updated Dec. 2011)



(Source: US PREF, www.uspref.org, Novogradac & Company, October 2012)

This article first appeared in the November 2012 issue of the Novogradac Journal of Tax Credits.

© Novogradac & Company LLP 2012 - All Rights Reserved

Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.novoco.com.