RENEWABLE ENERGY WORLD

Why the 2018 Solar Tariffs and Tax Cuts Didn't Kill Solar PPAs

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June 22, 2018

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At the end of 2017, the solar industry braced for a shock. Congress had just passed the Tax Cuts and Jobs Act, reducing tax rates and the demand for tax credits. President Trump finally had the opportunity to impose the tariffs he pined for since his inauguration in the form of the Suniva 201 trade case. The long feared nuclear winter appeared to be at hand. But then something funny happened…it wasn't.

Solar industry concerns about how to survive these seemingly devasting impacts grew primarily out of the way energy projects are planned. Years before a project commences construction, developers identify offtake opportunities, typically bidding into competitive power auctions run by procuring entities. Because offtake commitments are obtained relatively early in the development process, auction pricing typically depends on some projection as to the cost of capital and the cost of equipment. When those projections prove unfavorably inaccurate, project economics suffer and, in some cases, projects are terminated.

At the start of 2018, it appeared tax reform would lower the supply of taxable income, thereby increasing the cost of tax equity, and the Suniva case would increase the cost of equipment. The confluence of these circumstances would unhinge PPA pricing assumptions formulated years earlier and plow under project economics, causing them to be delayed or shelved, ultimately resulting in disruption of a frothy industry.

Thus far, fears of an industry shakeout have been unfounded. Since the calendar flipped financings have been brisk. Module supply has not proven to be a drag on EPC execution or financing.

How could everything that should have gone so wrong, go so right?

With one major caveat – we are not yet six months into the year – the tax equity markets have proven resilient and a less harmful than expected tariff, coupled with solid planning, have blunted the political impacts on the industry.

Tax Equity Markets – Stronger Than Expected

The 21 percent tax rate (and, in some cases, the base erosion tax) imposed by the Tax Cuts and Jobs Act were supposed to constrain the supply of tax benefits, and for each individual investor it seems to have had that impact. Indeed, tax equity yields have ticked up modestly in 2018, reducing the tax-equity that can be raised for each project.

But the tax investment community, perhaps unwittingly, has been preparing for this moment. Investors who find themselves short on tax liability have pivoted partially or wholly from consumers to aggregators. A number of investors who had dipped a toe into tax investment have increased commitment to acquiring tax benefits. Some tax investors who had limited their role to syndicate participation have also begun sourcing their own deals directly with sponsors.

The step down and phase out of renewable tax credits also looms on the horizon. For wind projects, this is an absolute sunset, with the production tax credit reducing towards expiration for projects that start construction after 2019. Solar investment tax credits, on the other hand, step down to 10 percent for projects that do not start construction by 2021 or are placed in service after 2023, but do not fully expire under current law. The reduced availability of tax credits from wind and solar projects has factored into the commitment sponsors have to developing new solar projects.

Any decrease in tax credit demand has been adequately offset by new investor participation, at least to date. Moreover, the industry seems to be moving towards a "normalization" in tax equity pricing as uptake of tax credit demand continues to grow and the projected supply of tax credits slackens.

Managing The 201 Tariff

In its 201 trade proceeding, Suniva asked the federal government to impose a 100 percent tariff on silicon cells and modules imported into the United States. The outcome announced by President Trump in January was far less damaging. A 30 percent tariff was placed on global imports, with a 2.5 GW annual exclusion for cells to soften the blow. Additionally, the tariff ramps down by 5 percent each year through 2021 and then ends in 2022. The expectation that these duties would kill solar project finance has not been borne out for several reasons.

Thin film photovoltaic technology like that manufactured by First Solar, was never targeted by the Suniva case. This technology, which accounts for between a quarter and a third of the U.S. market, remains exempt from the tariff.

Manufacturers and sponsors aggressively on-shored equipment in the months leading up to the Suniva decision. As a consequence, upwards of a year of PV equipment supply will avoid the tariff.

Several PV suppliers, including Jinko Solar, Hanwha Q Cells and SunPower, have announced plans to relocate manufacturing to the United States. Other manufacturers are said to be considering similar moves. Supply from these operations could become available as soon as 2019.

Finally, some believe that the World Trade Organization will find that the tariff violates international law. If this happens and the tariff is not rescinded, the United States' other strategic international trade agreements could be jeopardized, sparking an open, global trade war. This dynamic was the impetus for the end of George W. Bush's steel tariff policy in 2002.

In light of these factors, sponsors have neither abandoned near-term projects, nor stopped planning for projects beyond 2019.

Timing Is Everything

Ultimately, the impacts of tax reform and the Suniva tariff are a question of timing. Some projects have certainly been affected, resulting in requests to re-price offtake agreements. In certain cases, re-pricing will be impossible and those projects may not survive. It is difficult to get offtakers to renegotiate their power purchase agreements as a general matter, particularly if there are other developers in the market that have stockpiles of non-tariffed equipment.

In some cases, it is impossible or very difficult to renegotiate contracts due to the manner in which the agreement was struck. Projects in jurisdictions with avoided cost PPAs will have a hard time changing the price, as will projects with offtake agreements that were bid out in an auction process.

That said, other projects will achieve economically sustainable outcomes and emerge from this shroud of political uncertainty.

Taking the longer view, projects that are negotiating offtake agreements now, for construction in 2019 or 2020, may be largely unaffected by the tax and tariff double-ding. Those projects will have the opportunity to factor in the new impacts of these policies. Consequently, the price of procuring solar power could generally increase, though as long as there is demand for solar energy (whether due to carbon regulation or corporate social impetus) the solar industry should continue to survive, if not thrive.

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