

# Novogradac Journal of Tax Credits

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## Q&A Structuring Renewable Energy Projects in the Post 1603 Grant Era

By Tony Grappone, CPA, Novogradac & Company LLP

**Q**uestion: How will developers whose renewable energy projects are not safe-harbored structure their deals and raise financing now that the Section 1603 grant has expired?

**A**nswer: Although raising traditional tax equity is the obvious answer, developers are going to weigh all their options.

As you know the Section 1603 grant program provided renewable energy projects with a subsidy, 30 percent for technologies such as wind and solar, in the form of a cash grant payment from the U.S. Department of the Treasury (Treasury). This was a great option for most developers because it allowed them to forego monetizing the 30 percent investment tax credit (ITC) through a traditional tax equity raise and, in lieu of claiming the ITC, opt for a 30 percent grant payment from Treasury. This also allowed developers to own their projects without having to admit a third-party investor, giving them complete control over their destiny. For most developers this allowed for smooth sailing. Now that the Section 1603 grant has expired, those projects that are not safe-harbored are scurrying to figure out their financing options. Although the grant has expired, the ITC program still exists and therefore renewable energy projects still have a 30 percent ITC they can monetize. Project sponsors, however, are being careful to test all waters before setting sail on what they see as rough seas.

*Structuring Options:*

### **Non Traditional Investors (Co-Developers)**

Although 2012 has only begun, there is already a lot of dis-

cussion among project sponsors/developers about pursuing non-traditional investors in the form of co-developers. The first question that developers are asking isn't "how can I assist them with a tax equity raise" but rather "how can I help them network with other developers who have safe-harbored a general pipeline of property and which may be a good fit for their project(s)." That's right, developers of projects that are not safe-harbored are looking to admit as investors other developers that own safe-harbored property.

There are a variety of reasons that these project sponsors/developers are hoping that negotiating with other developers is easier than negotiating with a tax equity investor. First, the other developer will understand their business better than a tax equity investor, which could lead to quicker negotiations. Second, a fellow developer will likely be more committed to the operational success of the project. Third, a co-developer/investor brings not only capital (like a tax equity investor) but also know-how that makes their capital "smart" money, which is something tax equity is less apt to bring to the table. Fourth, it allows the project to retain grant eligibility, which is what the market generally prefers. Fifth, the other developer may have other strategic relationships with suppliers and/or lenders, etc., which could yield

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other financing efficiencies. Sixth, and probably most importantly, many developers perceive they will raise substantially more equity with the grant than they will via a traditional tax equity raise.

That being said there are obvious downsides to working with a co-developer. First, by admitting a co-developer, the initial developer will most likely have to forfeit significant control to the new developer, which is a dreaded consequence of any project sponsor. Also, there is no guarantee that working with a co-developer is a better economic arrangement than working with a traditional tax equity source. From a structuring point of view, there are many options to explore and advisors should be consulted on the pros and cons of each. For example, the developer could sell 100 percent of the project company and retain no ownership post sale; a co-developer could be admitted as a partner in a partnership; or, the developer could take a hybrid approach that involves some sort of partnership arrangement with the partnership later dissolved. The differences are stark and it's important to take care in understanding all the options, which involves analyzing the numbers under each scenario being considered and then weighing each option accordingly.

### Traditional Tax Equity Investors

Although project sponsors will test the non-traditional investor market, the natural course is to pursue traditional tax equity. From a structuring view, this usually involves owning the project as part of a partnership and admitting at least one investor limited partner (ILP). There are three common partnership structures to consider when raising tax equity.

First, there is a basic limited partnership that is sometimes referred to as a "buy and hold" partnership in which an ILP contributes capital in exchange for, say, a 99 percent interest.

Second there is what is referred to as a partnership flip (flip), which is well-known among renewable energy participants. The basic difference between a buy and hold and a flip is that in a flip transaction the ILP and project sponsor's ownership interests flip at a future point in time, generally many years prior to the end of the partnership, in order to facilitate a redemption of the ILP's interest in a manner that is more affordable to the project sponsor. Flips are generally preferred by sponsors that cannot use the tax benefits generated in the early years but that want to receive long-term control and cash flow benefits. Flips are also generally preferred by ILPs that mostly value short-term tax benefits and that are perhaps less interested in holding a long-term interest in a renewable energy project entity.

The third partnership option is what I refer to as a lease pass-through (LPT). This structure is also known as a credit pass

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through, a master lease (not to be confused with a master limited partnership) and an inverted lease. Industry participants often use these titles somewhat interchangeably; however, they all mean the same thing. The LPT structure basically creates two separate partnerships; one to own the facility, owner or landlord, and another to operate the facility, tenant or lessee. This structure is particularly attractive to ILPs that place more value on the ITCs (plus some small amount of depreciation and cash flow). These ILPS are often eager to exit the deal once they have received the ITC and some basic level of profit on their investment. LPTs are also ideal for project sponsors that can utilize a good portion of the depreciation and that are also eager to redeem the ILP as soon as possible (LPTs may also have flip provisions). With LPTs the landlord incurs the costs to build the facility, however, it makes a special tax election to treat the tenant as acquiring the facility. The ILP makes its investment in the tenant entity. With LPTs the landlord entity generates the depreciation, the majority of which gets allocated to the project sponsor while the tenant entity generates the ITC and allocates the lion's share to the ILP. Thus the LPT structure nicely isolates and, to a large degree, separates the depreciation and ITC benefits. Thus if one investor values depreciation and another values the ITC, the investment can be structured in a way that accommodates both investors. It's more complicated but often allows project sponsors to maximize the value of their depreciation and ITC benefits.

This article was meant to shed light on new structuring options in the post-grant era. As developers evaluate what is best for their projects, Novogradac & Company LLP stands ready to help navigate these uncharted waters. ♦

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