



---

Portfolio Media, Inc. | 648 Broadway, Suite 200 | New York, NY 10012 | [www.law360.com](http://www.law360.com)  
Phone: +1 212 537 6331 | Fax: +1 212 537 6371 | [customerservice@portfoliomediamedia.com](mailto:customerservice@portfoliomediamedia.com)

---

## Treasury Grants For Renewable Energy Projects

Law360, New York (May 05, 2009) -- This article discusses the potential impact of new federal incentives for renewable energy projects on what has been one of the predominant financing methods for utility-scale renewable energy projects in the United States.

Prior to the passage of the American Recovery and Reinvestment Act ("ARRA"), the Production Tax Credit ("PTC") was the primary federal tax incentive for utility-scale renewable energy projects. The PTC provides the generator with (at the 2008 level) 2.1 cents of tax credit per kilowatt-hour of electricity produced.

A project is eligible for the PTC for a period of 10 years from the date it is placed in service. As the PTC is based on electricity generated, the generator assumes the risk that actual generation deviates from projected levels.

The PTC also has an unusual feature considering its underlying purpose to incentivize renewable project development — most developers cannot take advantage of it directly.

As the PTC is a tax credit, the entity claiming the credit must have tax liability to credit the PTC against. Most developers do not have sufficient taxable income to take advantage of the PTC.

The result is that developers often finance projects through tax equity financing, where an entity with sufficient tax appetite contributes equity to a project in exchange for the right to, among other things, the PTCs generated by the project.

This type of financing requires that the tax equity investor's investment in the project generate a predetermined internal rate of return ("IRR"), usually over the 10-year eligibility period for the PTC.[1]

When the tax equity investor achieves the predetermined IRR, the equity ownership of the

project “flips,” with the developer holding the majority equity position and the tax equity investor usually holding a very small minority position.

Prior to ARRA, the only utility-scale renewable energy projects qualifying for the Investment Tax Credit (“ITC”) were solar projects.

Rather than receiving tax credits for production, owners of ITC qualified projects receive a tax credit in the year the project goes into service equal to 30 percent of the tax basis of the project.

Utility-scale solar projects comprised only 454 MW of nameplate generation in the U.S. as of the end of 2008. Thus, the ITC has not been widely utilized for utility-scale renewable energy projects. Furthermore, as the ITC is a credit, it suffers from the same problem as the PTC.

The ARRA, signed into law in February 2009, includes several significant extensions for existing incentives and the creation of wholly new incentives for the industry. The ARRA included several provisions that directly affect financing structures for utility-scale renewable energy projects:

- 1) the sunset for the PTC for wind energy projects was extended through 2012 and for solar projects through 2013;
- 2) the ITC was expanded to include utility-scale wind energy projects; and
- 3) a Treasury Grant was established, with criteria that generally mimic the ITC and which provides for a cash payment from the Treasury Department equal to 30 percent of the tax basis in a qualified project.

Utility-scale wind and solar projects, among others, qualify for the Treasury Grant.

The PTC has been enacted in fits and starts over the years, and a major concern of investors has always been whether or not a project could be completed and placed in service before the PTC expired.

In ordinary times, a pronounced multiyear extension of the PTC, as is in the ARRA, would be cause for celebration. However, the seizing up of the financial markets, the collapse of Lehman Brothers, TARP and its alphabet-soup cousins have all dominated the headlines recently.

This is no ordinary time. The PTC relies on the existence of a pool of profitable investors with sufficient tax appetites who understand renewable energy, project finance and arcane sections of the federal tax code.

These investors were once plentiful. About two dozen financial institutions were at one time active investors in PTC-qualified projects.

Well-known U.S. institutions such as JPMorgan and Wells Fargo, as well as European banks with New York branches, provided sufficient tax equity financing to support new wind installations (with wind equaling over forty percent of all new U.S. generating capacity installed in 2008).

Like virtually every other market, particularly those that are capital intensive, the overall climate for renewable energy project development slowed in the latter part of 2008 and into the beginning of 2009.

First, the PTC for wind projects received a one-year extension in October 2008, extending it through Dec. 31, 2009. This de minimis extension created some skepticism in the market as to congressional commitment to renewable energy development.

Second, developers' dependence on tax equity investors became an Achilles' heel with the downturn of the U.S. market. Currently, there are only a handful of tax equity investors interested or capable of investing in renewable energy projects. And, like all other credit, the terms tax equity investors are demanding from renewable energy developers have tightened considerably.

Rather than being cause for celebration (welcome though it is to the industry), the extension of the PTC has taken a backseat to the Treasury Grant. This is because the Treasury Grant addresses many of the shortcomings of the PTC and, for that matter, the amended ITC.

First, it is a cash grant and, therefore, the tax appetite of the project owner is irrelevant. Second, as it is not production-based, there is no production risk.

Third, and again related to production, the Treasury Grant is awarded within a few months after an application is filed by a qualifying project, whereas the PTC is recovered over a 10-year period based on actual production.

While both the Treasury Grant and the ITC are equal to 30 percent of the project's basis, the basis is reduced by only 15 percent as a result of electing either one. The remaining 85 percent is then subject to depreciation under existing provisions of the tax code, most notably Modified Accelerated Cost Recovery System (or "MACRS").

Furthermore, for any project placed in service in 2009, bonus depreciation under Section 168(k) of the tax code remains available.

Given these recent developments and market turmoil, we began canvassing market participants about the selection of the PTC, ITC or Treasury Grant.

The idea for this article was born when, in response to our question "when would you choose the Production Tax Credit instead of the Investment Grant?" a respondent said, "the Production Tax Credit is dead."

While this may be true, it may be equally attributable to the decline in tax equity financing and the advent of new federal incentive programs.

It appears that in the current market, only a very rare project would choose the PTC over the Treasury Grant or ITC. Furthermore, the Treasury Grant appears to be favored over the ITC.

In reviewing the new incentive programs available to renewable energy projects under ARRA, one would assume it is as simple as doing the math to determine the suitable choice for any given project: the cost of the project, the nameplate capacity of the project, the expected capacity factor, evaluate the forward price curves for electricity and renewable energy credits, calculate a net present value and review the results.

The point is that performing this analysis is anything but simple. It requires assumptions and assumptions can be wrong. Utilizing the ITC or Treasury Grant eliminates these risks.

As a result, it is not simply that market participants will elect the incentive with the greatest net present value. It appears that they will elect the ITC or Treasury Grant unless the PTC results in a significantly better net present value.

Additionally, the Treasury Grant has the added benefit of not requiring a tax appetite in order to take advantage of it. Thus, the Treasury Grant is viewed as "a bird in hand."

From what we have heard in the market, most market participants expect to employ tax

equity financing with the Treasury Grant. Some market participants believe including the Treasury Grants in their tax equity financing structures will revive the flagging tax equity market.

While probably true, this will be an unknown until Treasury firmly establishes the guidelines for the grant program and demonstrates the ability to implement it effectively. This has yet to occur.

However, once implemented, the inclusion of Treasury Grants in a tax equity structure should significantly reduce a tax equity investor's recovery period and drive down the overall cost of tax equity financing.

What we do know is that the reaction by market participants to the idea of the Treasury Grant program is quite favorable and, assuming effective implementation, it is likely to displace the PTC as the preferred tax incentive for financing renewable energy projects, at least in the near term.

The downturn in the market and the significant reduction in tax equity financing has resulted in only the projects with the best development profiles obtaining tax equity financing.

When these projects come online, they very well could be projects that will favor the PTC over the ITC or the Treasury Grant. Thus, while the PTC may be taking a backseat in the current market, it is unlikely that it is truly "dead."

--By Patrick E. Groomes (pictured) and Paul J. Astolfi, Kirkland & Ellis LLP

*Patrick Groomes is a partner in the energy group of Kirkland & Ellis in the firm's Washington, D.C., office. Paul Astolfi is a partner with firm's finance group in the Chicago office.*

*The opinions expressed are those of the authors and do not necessarily reflect the views of Portfolio Media, publisher of Law360.*

[1] A detailed discussion of tax equity financing is beyond the scope of this article.