

ENERGY BOOTCAMP SERIES

Financing of Renewable Energy Projects

Tuesday, September 10, 2013



©2013 Foley & Lardner LLP

13.9398

Speakers



Jeff Atkin
Partner
Solar Industry Team – Chair
jatkin@foley.com



John Eliason
Of Counsel
Tax and Individual Planning
jeliason@foley.com



Ed Hammond
Partner
Finance & Financial Institutions –
Vice Chair
ehammond@foley.com

©2013 Foley & Lardner LLP

13.9398

Basic Capitalization of a Renewable Energy Project

- Construction/Bridge/Term or “Permanent” Financing (including letter of credit facility)
 - 50%-70% of project cost
 - Debt facilities can be obtained separately or combined in a single agreement with one lender;
 - Multiple facilities from different lenders can create difficult intercreditor issues

©2013 Foley & Lardner LLP

13.9398

Basic Capitalization of a Renewable Energy Project

- Permanent financing may include separate tranche of long-term fixed rate debt
 - Institutional investors (life insurance companies, pension funds, etc.)
 - 25%-50% of total capital structure
 - Up to 20-25 year maturity

©2013 Foley & Lardner LLP

13.9398

Basic Capitalization of a Renewable Energy Project

- Tax Equity Investment
 - 25%-35% of total capital structure
 - Funding occurs after construction completed and just before project is “placed in service” for tax purposes
 - Proceeds pay off all or some portion of construction or bridge financing

©2013 Foley & Lardner LLP

13.9398

Basic Capitalization of a Renewable Energy Project

- Cash/Sponsor Equity
 - 5%-15% of total capital structure
 - Sponsor has ability to retain long-term control of project after return on tax equity investment is realized

©2013 Foley & Lardner LLP

13.9398

Financing Sources Available for Renewable Projects

- Bank market
- Private placement of institutional debt
- Tax equity investors
- Balance sheet of project sponsor (or its parent)
- Vendor and contractor financing

©2013 Foley & Lardner LLP

13.9398

Financing Transaction Process

- Preliminary due diligence – lender/investor assessment of viability of project:
 - Site
 - PPA and other project contracts
 - EPC Contract
 - Operations and Maintenance (O&M)
 - Annual operating budget
 - Equipment supply
 - Permits and approvals
 - Project Model - financial projections
 - Project management

©2013 Foley & Lardner LLP

13.9398

Financing Transaction Process (cont'd)

- Commitment letter – key terms and conditions, including structure, collateral, pricing and fees, key covenants, conditions (credit approval, documentation, approval of model), payment of lender expenses
- Definitive Loan Documentation and further due diligence – credit agreement and collateral documents, project contracts, third party consents, reserve funds and accounts
- Closing – certificates, legal opinions

©2013 Foley & Lardner LLP

13.9398

Construction Financing

- Traditional bank loan with typical structure, terms and conditions of a project financing
- Construction loan disbursement procedures – detailed requirements designed to provide assurance to the lender that the project is on track and available funds and committed financing sources are sufficient to complete the project

©2013 Foley & Lardner LLP

13.9398

Construction Financing

- Construction loan disbursement procedures
 - Lien waivers from contractors
 - Construction expenses and schedule are in accordance with budget; Lender wants assurance that project will reach commercial operation and begin generating revenues
 - Title insurance endorsements
 - Certificates from independent engineer and other project consultants
 - Confirmation of reps and warranties, no default, etc.
 - Remaining funds plus equity sufficient to pay all remaining project costs

©2013 Foley & Lardner LLP

13.9398

Construction Financing

- At maturity (scheduled completion date), construction loan is required to be repaid in one of two ways:
 - Third party takeout requirement – commitment for permanent financing or sale of project
 - Conversion to term loan – requires commercial operation, payment of construction costs, generation of project revenues

©2013 Foley & Lardner LLP

13.9398

Permanent Debt Financing

- Debt sizing and amortization based on financial model
 - Model shows project revenues (primarily PPA payments) and project expenses; debt is sized into the model at a level that will produce sufficient debt service coverage over the term of the financing
- Structure and terms generally similar to construction loan, with shift in focus from construction to operating integrity of project:
 - Mortgage and security interest in project assets
 - Pledge of ownership of project company
 - Reserve funds
 - Covenants

©2013 Foley & Lardner LLP

13.9398

Tax Equity Investment

- Monetizing of tax benefits
 - Project developers and sponsors often cannot effectively utilize tax benefits
 - Tax benefits accrue to the owner of the project
 - Owner is normally a limited liability company or other “pass-through” entity for tax purposes, so tax benefits flow through to equity owners of project company
 - Such owners need to have taxable income sufficient to produce “appetite” for tax benefits

©2013 Foley & Lardner LLP

13.9398

Tax Equity Investment

- Monetizing of tax benefits
 - Tax equity investment allows developers to transfer tax incentives to investors, enabling developers to share in the economic benefits
 - Tax equity investors are usually banks, insurance companies and other institutional investors

©2013 Foley & Lardner LLP 13.9398

Tax Equity Investment

- Federal tax benefits
 - Investment Tax Credit (ITC)
 - Production Tax Credit (PTC)
 - Depreciation
- Section 1603 cash grant
- State benefits

©2013 Foley & Lardner LLP 13.9398



Tax Equity Investment

- Investment Tax Credit (ITC)
 - One-time credit equal to 30% of the cost of qualified energy property (10% for certain technologies)
 - Credit is claimed in year project is placed in service
 - No requirement to sell energy output
 - Subject to recapture

©2013 Foley & Lardner LLP

13.9398



Tax Equity Investment

- Production Tax Credit (PTC)
 - Credit equals 2.3 cents per kWh of electricity produced by the taxpayer from qualified energy sources (1.1 cents per kWh for certain technologies)
 - Electricity must be sold to unrelated person during taxable year
 - PTC available for first 10 years from original placed in service date
 - Not subject to recapture
 - PTCs available for used property

©2013 Foley & Lardner LLP

13.9398

Tax Equity Investment

- Accelerated depreciation (MACRS)
 - Provides for “front loading” of cost recovery deductions
 - Generally, MACRS allows renewable energy property to be depreciated over 5 years
- “Bonus” depreciation
 - Special depreciation allowance for new property placed in service after 2007 and before 2014
 - For qualifying property (including renewable energy property): 50% of cost
 - Remaining cost is recovered under MACRS
 - Not “more” depreciation, just more front-loading

©2013 Foley & Lardner LLP

13.9398

Tax Equity Investment

- Financing options – converting tax benefits into financing
 - Structuring options are often complex
 - Tax incentives generally follow ownership
 - Developer/sponsor wants to remain as long-term owner
 - Tax equity investor views itself as a lender
 - Extent to which developer is able to utilize tax incentives will vary

©2013 Foley & Lardner LLP

13.9398

Tax Equity Investment

- Structuring options:
 - Partnership structures
 - Traditional partnership
 - Partnership “flip”
 - Pay-as-you-go (“PAYGO”)
 - Other financing structures
 - Sale-leaseback
 - Inverted lease
 - Prepaid PPA

©2013 Foley & Lardner LLP

13.9398

Tax Equity – Adding Debt

- Project-level debt
 - Part of capital stack
 - Leverage improves yields
 - Forbearance?
- Back leverage
 - Upper-tier debt funds sponsor’s equity contribution
 - Allows sponsor to rely upon lower cost of capital
 - Secured by sponsor’s equity interest in project partnership and/or other assets
 - Loan is made to sponsor outside of the project debt structure

©2013 Foley & Lardner LLP

13.9398

Debt Structure and Terms

- Lender control of project assets
 - Mortgage and security agreement covering project assets
 - Project assets held in a separate legal entity (“project company”) whose limited purpose is to own and operate the project
 - Equity pledge of project company
 - Collateral assignment of project contracts
 - Consents and agreements from counterparties under project contracts – PPA “offtaker”, EPC contractor, O&M contractor; equipment supplier, project site owner
 - Controlled project accounts – waterfall

©2013 Foley & Lardner LLP 13.9398

Debt Structure and Terms

- Non-recourse to project sponsor
 - Project assets and revenues are lender’s sole source of repayment
 - Resulting focus on project contracts and counterparties
 - Project sponsor or its parent may provide limited guaranties for specific purposes such as reserve funds

©2013 Foley & Lardner LLP 13.9398

Debt Structure and Terms

- **Mandatory Prepayments**
 - Condemnation/casualty events (subject to reinvestment provisions)
 - Sales of assets (limited amounts; subject to dollar limitations)
 - Liquidated damages (if paid by project contractor or warranty provider)
 - Retained cash held for certain period of time under cash trap due to failure to meet distribution conditions
 - Failure to complete construction and reach commercial operation by an outside date certain

©2013 Foley & Lardner LLP 13.9398

Debt Structure and Terms

- **Sample payment priority “waterfall” provision – all project revenues applied to the following obligations in the following order:**
 - Project operating and administrative expenses (in accordance with approved project budget)
 - Fees and expenses of lenders
 - Interest on project debt, letter of credit fees and ordinary course interest rate swap settlements
 - Scheduled principal amortization on project debt, LC loans due at maturity, swap breakage costs, prepayment premiums

©2013 Foley & Lardner LLP 13.9398

Debt Structure and Terms

- Sample payment priority “waterfall” provision – all project revenues applied to the following obligations in the following order:
 - LC loans and unreimbursed LC drawings
 - Funding of debt service reserve, maintenance reserve and other reserve accounts
 - Transfer to distribution account for distribution to sponsor (subject to distribution conditions)

©2013 Foley & Lardner LLP 13.9398

Debt Structure and Terms

- Covenants
 - Debt service coverage ratio
 - Usually not a maintenance covenant
 - Cash trap – restriction on dividends up to sponsor
 - Modification of project agreements
 - Materiality
 - Preparation and modification of annual operating budget
 - Standard affirmative and negative covenants

©2013 Foley & Lardner LLP 13.9398

Debt Structure and Terms

- Sample distribution conditions:
 - [1.20x] historical debt service coverage ratio measured for preceding 12-month period
 - [1.20x] projected debt service coverage ratio based on approved financial projections for succeeding 12-month period
 - Prior funding of all reserves (to the extent then required and not otherwise covered by a letter of credit or parent guaranty)
 - Absence of outstanding LC loans or unreimbursed drawings under letters of credit
 - No Default or Event of Default

©2013 Foley & Lardner LLP 13.9398

Contractor/Vendor Financing

- Project contractor can “self-finance” its own contract by deferring contract payments
- Equipment supplier can provide financing through extended payment terms (intentionally or not)
- Consider what terms may apply to these forms of financing:
- Does the project contract include a security agreement?
 - Granting language; description of collateral; signed by the debtor
 - “Authentication” of “record” – can be electronic signature
 - Security agreement can be a paragraph in sales contract
 - “Battle of the forms” – may be an issue whether project owner has agreed to the terms and conditions that include the security agreement

©2013 Foley & Lardner LLP 13.9398

Contractor/Vendor Financing

- UCC filing
 - Filed electronically; no signature required
 - Authorization to file in signed security agreement
 - Description of collateral – limited to goods sold or include other debtor assets?
 - Where to file? If the collateral is inventory or equipment in the hands of the debtor, then at the Secretary of State or other central filing office in the state where the debtor is organized (not necessarily where debtor’s offices or operations are located - if debtor is a Delaware company, file in Delaware)

©2013 Foley & Lardner LLP

13.9398

Contractor/Vendor Financing

- UCC filing
 - Where to file? If collateral is installed at the project, might be “fixtures” which requires a special filing, including name of the record owner of the real estate where the collateral is located and a legal description of the real estate, filed with the real estate records in the registry of deeds for the county where the real estate is located (like a mortgage)
 - Note: a UCC financing statement is not a security agreement – both are needed to obtain a perfected security interest

©2013 Foley & Lardner LLP

13.9398

Contractor/Vendor Financing

- Purchase-money priority
 - Depends on the nature of the transaction
 - A “purchase-money obligation” is an obligation incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or use of the collateral is the value is in fact so used
 - No special requirements for collateral other than inventory
 - For inventory, must notify other secured creditors
 - Are the goods “equipment” or “inventory” in the hands of the debtor/buyer?

©2013 Foley & Lardner LLP

13.9398

Contractor/Vendor Financing

- Purchase-money priority
 - Conduct UCC lien search to determine whether buyer has other secured creditors with security interest in debtor’s inventory

©2013 Foley & Lardner LLP

13.9398

Contractor/Vendor Financing

- Third party agreements
 - Owner/operator of warehouse where goods are stored
 - Owner of project site
 - Terms:
 - Acknowledgement of vendor's security interest
 - Waiver of any interest in collateral
 - Grant of access to site to seize and dispose of collateral

©2013 Foley & Lardner LLP

13.9398

Contractor/Vendor Financing

- Security provides significant benefits to creditor and imposes restrictions on debtor:
 - Priority as against other creditors
 - Limitations on sale or other disposition of collateral
 - Rights in bankruptcy
 - Remedies
- Other forms of payment security
 - Letter of credit
 - Affiliate guaranty
 - Cash on delivery

©2013 Foley & Lardner LLP

13.9398