



INDIAN ENERGY SOLUTIONS 2007
Meeting America's Need for Clean Energy
With Tribal Renewable Resources

FINANCING INDIAN ENERGY

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Discussion

- Why Renewable Project finance is the way it is

Harry S. Truman:

“I never did give them hell.

I told the truth, and they thought it was hell.”

- Players
- Challenges & Opportunities/Options

Energy Tax Subsidies & Structuring Challenges

- **Federal Tax Subsidies for Energy Development**
 - §29 Credits – Non Conventional Gas Production Tax Credits
 - §45 Credits – Renewable Energy Production Tax Credits (\$.019/kWhr generated)
 - §48 Credits – Renewable Energy Investment Tax Credits (10% or 30%)
 - § 168 Modified Accelerated Cost Recovery System (Accelerated Depreciation) – 5 years
 - §45D New Markets Tax Credits
- **Creates challenges for non-taxable entities (Tribes, municipalities, electric cooperatives, other governmental entities)**
- **Creates challenges now for most developers, even large taxable entities**
- **Solution: Innovating flexible, creative transactional structures that can take advantage of significant tax incentives and create value for all Parties**

§ 45 Production Tax Credits

- Claimed for 10 yrs for electricity generated from placed into service before Dec 31, 2008
 - Wind
 - Biomass
 - Geothermal steam or fluid
 - Landfill gas
 - Water (new turbines installed at existing dams)
- Subject to haircut to extent project benefits from grants, tax exempt bonds, subsidized energy financing or “other credits” (federal; specific)
- Biomass can be tricky if mix-fuels plants use more than a de minimum amount of material that is not defined as acceptable biomass

§ 48 Investment Tax Credits

- Up to 30% tax credit of cost of new equipment for solar equipment for electricity generation (drops to 10% after Dec 31, 2008)
- State payments (incentives) may reduce basis eligible for federal credit
- No utility property, non-solar project property
- Pays for 60% of capital cost of typical solar projects (with application of 5-year MACRS)
- Solar- applicable; being more commonly structured into leveraged leases

§ 168 Modified Accelerated Cost Recovery System

- Accelerated depreciation of equipment to 5 years
- Tax savings are worth approx. 30 cents per dollar of capital cost

Important Notes:

- **American Jobs Creation Act of 2004:** Starting in 2010, companies generating electricity for sale can deduct 9% of revenue from sales under provision to encourage “domestic manufacturing” (until then, the deduction is 6%)
- **Tribal Accelerated Depreciation §168(j) – MACRS Turbo** - in the case of 5-year property, these federal provisions *further* accelerate the recovery period to 3-years (also needs reauthorization)
- **Employment Tax Credit.** Employers may take 20% employment tax credit on the \$20,000 of qualified wages and health insurance costs paid to a tribal member or to their spouse, living on or near a reservation and earning less than \$30,000 per year. The credit is available for qualified wages and health care costs paid after January 1, 1994 through the year 2003 (25.U.S.C.45A). This law has been extended to the year 2012.

§45D New Market Tax Credits

- Community Renewal Tax Relief Act of 2000 - To date, the Fund has made 294 awards totaling \$16 billion in allocation authority.
- Permits taxpayers to claim a credit against Federal income taxes for Qualified Equity Investments (QEIs) made to acquire stock or a capital interest in designated Community Development Entities (CDEs) which must use substantially all (defined as 85%) of proceeds to make Qualified Low-Income Community Investments (QLICIs)
- An individual or corporate investor can receive a tax credit worth 39% of initial investment, distributed over 7 years, along with any anticipated return on their investment in the CDE
 - investor receives a tax credit equal to 5% of the total amount paid for the capital interest or stock purchase over the first 3 years
 - In remaining 4 years, the value of the tax credit is 6% per annum
- 45 Native CDFIs currently certified entity, emerging Native CDFI or sponsoring entity
- Treasury Regulations (2004): *“Other Federal tax benefits—(i) In general. Except as provided in paragraph (g)(3)(ii) of this section, the availability of Federal tax benefits does not limit the availability of the new markets tax credit.”*

Challenge

- Tax subsidies of this magnitude are:
 - not useful to most project developers due to tax rules and
 - not applicable to governmental entities and Tribes

Question: So how do you structure agreements and financing to capture this significant federal tax assistance?

Addressing Capital Need

- Venture Capital
 - \$1.9B 1st half 2007
- Developer Partner
- Deploying Tribal Capital

THE SUSTAINABLE INVESTING SURGE

\$1.9 billion

Value of venture capital invested in clean technology companies

\$0.17

\$0.07

'90

'07*

*THROUGH SEPT. 30, 2007.
SOURCE: THOMSON FINANCIAL

Partnerships (PTC)

Partnership “Flips”

- Developer brings institutional equity investor to own project; allocated returns until tax credits have run or target return reached, then Investor’s interest then flips down
- Keep in mind: *Credits follow taxable income*

New IRS Revenue Guidance – Issued November/2007

- (1) *The Investor’s investment return must be reasonably anticipated to be derived from both section 45 credits and participation in operating cash flow;*
- (2) The Developer must have a minimum 1% interest in all partnerships items, including section 45 credits;
- (3) The Investor must have a minimum interest in partnership income and gain equal to 5% of its largest share of such items during its ownership of an interest in the partnership;
- (4) The Investor must make and maintain at least a 20% minimum investment (not protected against loss) in the Project Company, but reduced for distributions of cash flow;
- (5) *At least 75% of the Investor’s capital contributions must be fixed and determinable and not contingent in amount or certainty of payment;*
- (6) *Neither the Developer, the Investors nor any related parties may have a purchase option at a price less than fair market value (determined at the time of exercise);*
- (7) The Developer (or party related to the Developer) may not have a purchase option exercisable earlier than five years after the wind facility is first placed into service;
- (8) *Neither the Project Company nor the Investors may have a put option with respect to the Wind Farm, property included in the Wind Farm, or interest in the Project Company;*
- (9) No person may guarantee or otherwise insure the Investor the right to any allocation of the section 45 credit;
- (10) The Project Company must bear the risk of wind availability (no guarantees except from third parties if the Project Company or an Investor directly pays the cost of or premium for such guarantee);
- (11) The Developer (or a party related to the Developer) may not lend any Investor the funds or guarantee any indebtedness with respect to acquisition of its interest; and
- (12) *Section 45 credits must be allocated in accordance with the partnership rules (e.g., in the same manner as receipts from the sale of electricity produced at the Wind Farm are allocated).*



Other Common Financing Structures

Description	Cap Structure	Likely Equity	Structure Mechanics
Corporate	All equity	Developer	Corp develops and finances all costs, utilizes tax benefits
Strategic Investor Flip	All equity	Developer & Strategic Investor	Strategic investor contributes all equity, receives pro rata % cash & tax benefits prior to return based flip in the allocations
Institutional Investor Flip	All equity	Developer & Institut. Investor	Institut. Investor contributes most of equity, receives all tax benefits and all cash benefits until return-based flip in allocations after developer recoups investment

Other common financing structures – continued

Description	Cap Structure	Likely Equity	Structure Mechanics
Pay as you go	All equity	Developer & Institut. Investor	Institut. Investor finances much of project, injecting some equity on front end and over time as PTCs are generated. With return based flip in the allocations.
Cash Leveraged	Equity & Debt	Developer & Institut. Investor	Like strategic investor flip, adding debt; loan size/amortization based on amount of cashflow from power sales
Cash & PTC Leveraged	Equity & Debt	Developer & Institut. Investor	Similar to above, but loan size an amortization profile based on cash flow from power sales plus monetization of projected PTCS from project
Back Leveraged	All equity (developer uses debt outside project)	Developer & Institut. Investor	Identical to institutional investor flip, but developer leveraging equity stake in project using debt financing

Leveraged Leases (ITC)

- **Sale Leaseback**
 - Must be done within 3 months after project originally placed in service
- Lessee gets PTCs and deductions for rent equivalent to tax depreciation
- Lessor keeps actual tax depreciation and shelters the rents

Governmental (Tribal) Finance Models*

- **Bond Finance**
 - Best option if government entity has available capital through an existing bond or other long-term financing mechanism
 - Tribal *Essential Governmental Services Test* creates challenges
 - ✓ If on-site to serve entirely reservation loads, clearer case
 - ✓ Coupled with clean energy renewable bonds which are to fund renewable equipment, or USDA loan/grant programs, can be viable alternative to taking tax subsidies
- **Public Agency Power Purchase Agreement**
 - Public agency commits to purchase power (kWh) at fixed prices from a solar power system sited on its property for specified length of time; takes advantage of tax credit through a third party tax investor
 - A “Pay-as-you-go” power purchase agreement
 - Lots of other governmental/public utilities out there which make it more advantageous to partner with other governmental/public entities

* All are works in progress

Tribal Finance Models/Options – continued

- Prepay – credit/collateralization
 - Hybrid financial structure where public agency pre-pays for a fixed amount of power (kWh) at a fixed price
 - pre-payment allows for substantial discount from 3rd party investor
 - Can be funded via governmental financing structure
- Municipal Pre-pay financing structure
 - Sponsor (Municipal, Developer, Govtl Entity) completes *all* development
 - Governmental off-taker prepays all or portion of energy and capacity with bond issuance
 - Tax investor contributes value of preferred tax and cashflow profile, flip after base case return, year 10 target
 - Catches...

Tribal Finance Models/Options – continued

- DOE and DOI Guarantees - up to 80% of debt amount which cannot be more than 80% of project cost
 - May/07 Regulations NOFR issued for DOE – met across the board criticism
- Challenges: Subordination & Unguaranteed Debt Marketability
 - Government takes first lien
 - Lenders are in first loss position with respect to the 20% of their loan that is not guaranteed
 - ✓ Market Feedback: Can solve if work around can be structured on that 20% as a strip or pari passu first lien on unguaranteed piece
 - Oct/07 Regulations
 - ✓ Guaranteed portion of a partially guaranteed loan may be separated from or "stripped" from the non-guaranteed portion, except in cases where the guarantee exceeds 90% of the loan amount;
 - ✓ Allows for the possibility that lenders and holders of the non-guaranteed debt could share proportionately with the Department in proceeds from the sale of project assets pledged as collateral (pari passu structure will not be permitted to override the Department's superior right to project assets)

Ways to leverage/position for increased equity*

- **Develop Project Yourself**
 - Significant capital risk & no guaranteed return
 - Regulatory risk is real
 - Create solid, bankable, assignable asset pool
- **Keep it local**
 - Smaller Tribal load project has its financing challenges but can maintain control/ownership
 - Could be realistic for projects \$25M and less if Tribe willing to pay for all development
- **Phase Development and Leverage In**
 - Partner on an initial project
 - Negotiate options for increased capital or equity participation for later project

** Also works in progress...*

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