

Power Finance & Risk



Tax equity –
understanding
the evolution

PFR Tax Equity Roundtable 2023

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● PFR TAX EQUITY ROUNDTABLE 2023



EDITOR'S NOTE

The broad benefits of the Inflation Reduction Act of 2022 (IRA) has meant tax equity has never played a more crucial role in driving investment in renewable energy projects in the US. Yet, while many project finance practitioners have been busy readying themselves to take advantage of this new and improved tax equity regime, the devil – as always – remains in the details.

To shine some much-needed light on the evolving space PFR has brought together a panel of experts on tax equity to review the latest developments and innovations in this fascinating area of renewable energy finance, as well as the outlook for the coming years.

Happy reading!

Tom Duffell
Editor

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David Burton

David Burton, partner, Norton Rose Fulbright US

David Burton advises clients on a wide range of US tax matters, with an emphasis on project finance and energy transactions. He has extensive experience structuring tax-efficient financings for renewable energy projects. David also advises on structuring private equity funds intending to invest in renewables. His recent experience includes representing Eolian in the first-of-its-kind tax equity financing of two standalone utility-scale battery storage projects in Mission, Texas; and Republic Services, as a tax equity investor, in a \$344 million financing of a 175MW solar project in Charles City County, Virginia.



Spencer Tweed

Spencer Tweed, VP of Project Finance, Foss & Company

Spencer Tweed oversees the closing and diligence process for renewable energy and sustainability funds, bringing valuable experience from his previous role in project finance for a utility-scale solar developer, where he focused on coordinating tax equity and debt. He holds a BA in Real Estate from the University of Wisconsin and an MS in Finance from the University of Denver.



Patrick Klein

Patrick Klein, director, MUFG's Project Finance - Americas team

As a senior originator and team leader, Patrick is responsible for the origination, analysis, structuring, negotiation and execution of complex lease, equity and debt transactions. Patrick has worked in project finance since 2005 and has closed transactions totaling over \$12 billion and 1.5 gigawatts of renewable energy, including wind, solar, geothermal, biomass, biofuels and waste-to-energy transactions, as well as having worked on numerous other transactions involving infrastructure and transportation assets. Patrick has a Juris Doctorate degree from the UCLA School of Law and a Bachelor of Arts degree from Stanford University.



Julian Torres

Julian Torres, chief investment officer, Scale Microgrids

Julian is primarily responsible for guiding the investment strategy, structuring and deployment of Scale's capital into distributed energy resources and energy infrastructure assets. Prior to joining Scale, Julian was most recently a director in RBC Capital Markets' Global Investment Banking division where he was responsible for over \$1 billion of renewable energy tax equity investments, a position he held from 2015 to 2020. Julian's professional career spans over 15 years, beginning with Credit Suisse First Boston's Asset-Backed Securities principal investing desk. In that time, he assisted with closing over \$12 billion in structured finance transactions across commercial and consumer asset classes.



Andrew Waranch

Andrew Waranch, founder, president, and chief executive, Spearmint Energy

Andrew brings over 25 years of research, trading, and portfolio management experience across the electricity power markets to Spearmint Energy, having previously worked at energy trading firms, including Elustria, Elliott Associates, Deutsche Bank, Merrill Lynch, and Constellation Energy. He holds a BS in Applied Economics and Business Management from the Dyson School of Business at Cornell University.

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PFR

Let's kick off with a scene setter and start with an overview of the tax equity market. It peaked near the \$20 billion mark in 2021 – so are traditional tax equity investors tapped out? The current pool of tax equity investors is limited, which can create competition and make it challenging for some projects to secure the necessary financing. Is new capital coming to the market?

David Burton

So the tax equity market last year was \$18 billion or so. It was down a little bit from prior years of being \$20 billion, and I think the largest it ever got is about \$22 billion.

I think the tax equity market for traditional tax equity is to some extent tapped out, that that is both a function of tax appetite, but also because of capital weighting requirements imposed on the banks that are tax equity investors. I think that we're seeing a number of the traditional tax equity investors expand into transferability because that doesn't have the capital weighting issues – they don't have to put capital against it – so they seem eager to participate in that market as well. Even if you brought them the same deal, but as traditional tax equity they may not take it.

We are also seeing new entrants in transferability. Corporates who didn't want to become project finance experts but can just buy the credits are stepping up. Hopefully more step up and maybe over time they'll become traditional tax equity investors once they get kind of more

comfortable the markets. Maybe it's a transition. We're going to need a lot more than \$20 or \$22 billion of tax equity, but I think over that much of it's going to come through transferability.

Patrick Klein

I agree with David. We've seen something in the \$18 to \$22 billion range for a few years now, and, practically speaking, the supply side of tax equity has been constrained for a number of years for a variety of reasons. There are various barriers for new entrants.

What we do have now is long-term visibility on credits, which is one significant benefit of the IRA [Inflation Reduction Act] legislation, but another benefit as David mentioned is the transferability aspect. I think a lot of people who may otherwise be possible entrants into the tax equity space are likely to take transferability, and the relative simplicity that comes with it, as another reason not to do the brain damage of actually entering into the tax equity space.

I think there is also going to be a tremendous amount of additional demand for efficient users of tax credits that is going to far exceed, not only the current supply, but any sort of additional supply for traditional tax equity, which means increased demand for transferability and for new entrants. I think we're going to see a lot of non-traditional tax equity providers being active in the transferability space.

Julian Torres

To add on that, it always seems to be that when the investors are coming in to improve the size of supply of tax capacity, it's in response to some overwhelming expansion of the market and there just never seems to be enough supply. That's been my experience of the last 15 years.

There historically have been some technical supply crunches on the project side. I think end of 2016 was an example when the utility-scale solar industry was rushing to beat the end of the completion window that everyone thought was going to happen, we saw constraints on labor and a dearth of new projects to finance for several quarters. As I think about where we are in this cycle, we've had a massive expansion of the eligible technologies that can benefit from tax credits, for example I'm very excited that there's a micro-grid tax credit now embedded in Section 48. The expansion of eligible equipment to include interconnection expenditures is also very exciting,

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David Burton



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We're really excited about some of the new accounting methodologies that might help make it easier for players to come in.

Julian Torres

particularly for distributed generation. The result is it really brings what I think of our products, as being value added offerings, more on par with what was mainstream in terms of the net metered C&I solar offering in the distributed marketplace.

DG projects that are more value added in terms of resiliency weren't getting the same dollar for dollar tax credit value, and the new legislation levels the playing field a bit more which I'm very excited about.

We're definitely very much in a transition and the markets are adopting to some new norms. We're really excited about some of the new accounting methodologies that might help make it easier for players to come in. Proportional amortization is something that I think FASB came out and said would be an acceptable methodology for qualifying structures that meet certain criteria. It gives tax equity investors a new avenue to approach the market, instead of HLBV.

PFR: But to quickly go to Andrew, from the demand side rather than the supply side, how have you found working with traditional tax equity investors? And how are you positioning yourself to take advantage of new entrants into the space?

Andrew Waranch

At Spearmint Energy, we do a lot of modeling on the expected growth of the market. Right now, if you sum up the more robust estimates on storage, the general industry estimates are far under-shooting what the storage manufacturers and our models are predicting. Our analysis indicates that you could have \$500 billion of renewables in the next decade. That's a very large amount of money and that would require a significant increase in new entrants.

We see a lot of chemistry in the back offices of banks and accounting firms as well as tax equity or credit transfer providers who are seeking to solve this problem, specifically with respect to step up and creating step up. There are batteries that have traded in the market at almost 160% of cost and have been sold to third parties at that higher value because the buyers deemed it that value at that time. I believe there are some markets now where you'll see the market value of batteries be perhaps 200% of cost. Taking that into consideration, I think there are a lot of challenges ahead with respect to step up values and how to perhaps align those with the credit transfer methodology. But again, from a demand side, I think the demand is far, far greater than perhaps the tax equity community is prepared for.



PFR: On transferability, the Treasury issued the highly anticipated proposed regulations for the transfer of certain income tax credits under Section 6418 of the tax code last month. Where do we have certainty that we didn't before? What remains a grey area?

David Burton

We have certainty that the buyer does not have taxable income for the difference between the face value of the credit and what it paid. We also have certainty that if a partner sells its interest in the project that owns a partnership that that partner suffers recapture, not the not the buyer of the credit. And if a project suffers a casualty, or the whole project is sold, the buyer of a credit does suffer recapture. There's not a whole lot that that remains uncertain.

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There are some questions about exactly how partnership allocations work when a partnership sells the credit and gets cash and also gets tax exempt income. They still left it a little bit grey as to how that tax exempt income would be allocated amongst the partners for tax accounting purposes. But they generally filled in most of the questions the industry had. The industry doesn't necessarily like all the answers, but the answers are relatively clear.

People have been clearly very responsive in thinking ahead about the positions they'll be taking in advance of the guidance coming out.

Julian Torres

Julian Torres

From the commercial perspective it seems that the guidance allowed more dynamic and more confident discussions and allowing greater specificity in negotiations.

Having said that, there's still a few items yet to be clarified, pending the final rules, but we're seeing better engagement within the investor groups, and I think the conversations are proving much more fruitful, and that's been just observations

from the last few weeks.

People have been clearly very responsive in thinking ahead about the positions they'll be taking in advance of the guidance coming out.

Andrew Waranch

We have actually witnessed deals that that had been held or closed pending guidance, all of a sudden move forward. In fact, we saw one very small announcement in the press the other day.

I would expect a bit of an avalanche over the next few weeks as people either fund or close on transactions now that guidance is in place.

The more and more we engage with new players in this space – and by that I mean financial counterparties who have always been around tax equi-

ty but never been able to participate – the more we will see transactions executed. These new players are now really digging in and focusing on advanced hybrid structures.

Such players include private equity, but also various others offering hybrid structures and hybrid solutions, now that those investors feel that they can unload those tax credits. Therefore, we believe that this guidance was the last step required to unlock all of the financial engineering and complex structures to come to the market.

Patrick Klein

I think the transferability rules that were provided were relatively concise and clear, and I think the markets that were already forming will really open up now that we have this guidance. I think that there are certain challenges that are provided by the guidance, not that they were unexpected, but knowing the boundaries will be helpful in terms of folks being able to figure out the way forward as the market develops.

Spencer Tweed

I would add to that, at Foss, we've been having lots of conversations with financial institutions and corporations who are looking to get into tax equity but haven't participated in a partnership flip or an inverted lease structure before. Folks are very, very interested in transferability and now that we have this guidance it just reaffirms the conversations that we've been having, and you know I think that moving forward this is going to become a major portion of the market.

I can say at Foss we've been a little bit more focused on PTC transactions so far in the transferability space where we buy one more year of transferable PTC's.

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On the PTC transferability, one of the issues we're still working through is how to get investors who traditionally are only looking forward, you know the next 12 to 24 months when they're evaluating their tax appetite, who have participated in the ITC deals to commit to a 5 year or a 10-year PTC strip.

So, I think that there's going to be a bit of an education process on our end as we work with the investors, even in the PTC transferability case and acknowledging that there is the benefit of not having the same recapture assets associated with the ITC. We also have to get them comfortable with taking a longer-term view on what their future tax liability is so that they can get those five-year commitments or 10-year commitments that the developers want.

In terms of that issue, we're seeing the biggest, most bankable sponsors -- the name brands that everybody knows -- we're seeing them be able to sell 10 years' worth of PTCs to a single buyer.

David Burton

David Burton

In terms of that issue, we're seeing the biggest, most bankable sponsors -- the name brands that everybody knows -- we're seeing them be able to sell 10 years' worth of PTCs to a single buyer, while smaller, less well-known sponsors are having to do year by year sales.

So, they'll know they're kind of selling a year at a time and going out to the market and saying, who has tax appetite this year and wants my credits. It's a kind of a split in the market for the period of PTCs that are able to be sold between the bigger and smaller sponsors.

Patrick Klein

On the PTC deals, is anyone seeing challenges with the restriction on only cash consideration and then the corollary of the timing of the payment for the transfer?

I think that maybe this is something David can confirm, but is the correct interpretation/application of the payment timing rule is that you can't really have a fully front loaded payment for the full stream of PTCs? To some sponsors who need more liquidity up front, that may be a challenge. Is that the correct interpretation and is that a challenge that folks are seeing in the market?

David Burton

Yeah, Patrick, you are correct about that, that interpretation and that is an issue. So you know, if a sponsor wants to, you know, get value for 10 years' worth of PTC's, you can get value for let's say the



first year get cash and then it would need a loan for the remaining nine years and then that loan would be secured by the tax credit buyers obligation to purchase the remaining nine years of credits. So it's a little more complicated. I also haven't seen a whole lot of tax credit buyers who are eager to, pay for 10 years up front and any event. But there's definitely a role for lenders to play in liquidity in that situation.

Julian Torres

With the ITC structures I think that the firm obligation of a buyer that is bankable is inherently the most valuable because there's a pretty well-established marketplace for bridging facilities right now where project finance banks will allow sponsors to get that upfront value, or substantially most of it, in the form of a bridge loan.

The terms and conditions of those bridge loans may be improving now that there are more ways to manage a failed commitment or a tax change in law, or something that potentially would have made the bridge commitments to a tax equity investor somewhat riskier.

That's obviously going to be an evolving space. I think liquidity in tax credit marketplaces -- which would be sort of nontraditional and a very emerging means of accessing the investor base -- as well as maybe some innovation on the financing side with the players that really know the market and have been working with bridge loans for a long time, providing some of that access to capital.

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PFR: And what about the compliance burden that comes with transferability?

Patrick Klein

In terms of compliance, it is worth noting that these are proposed regs, and that there's still room for 'improvement' based upon comments. For the marketplace and for ease of compliance, perhaps one of the improvements that they make

is some increased optionality with respect to the requirement that each individual 'project' is required to make an election for transferability.

What comes to mind is utility scale wind projects or residential solar portfolios, things like that where each wind turbines considered to be a project, or you might have thousands of residences in a particular kind of transaction, so maybe there's room there for improvement in terms of not having to file in an election for each individual project.

Julian Torres

David, the guidance seemed a little quiet on the instance of a partnership selling the tax credits with a third-party investor, and what would constitute a good investor in that context, such that the transfer would be respected for its fair value. What thoughts do you have on that? Because I think a lot of people that were looking for that and I still haven't seen a lot of discussion on point about that topic.

David Burton

I'm not sure why people were expecting the guidance to address that, but I've gotten that question from a number of clients.

So that definitely was an idea in the air, but the I mean, it's kind of apples and oranges. The guidance is talking about how to transfer tax credits, what you're referring to is a question of, you know, what is a true sale for tax purposes versus a contribution and substance over form and those kinds of common law doctrines. And so it's really kind of outside the scope of the guidance.

I think the tax bar was not surprised the guidance was silent on that, though those issues are definitely coming to the forefront.

There's a fair amount of IRS audit activity on

those issues and the accounting firms who sign the tax returns are also getting more focused about it, more sensitive to them. So, it is something that the industry is giving a lot of attention.

Spencer Tweed

I would just say quickly one thing we haven't touched on that's come up in, in conversations with my development partners is a number of our development partners use the inverted lease and the guidance says credits can't be transferred out of the inverted lease structure.

And this is interesting because we've seen developers with large amounts of tax credits who were planning the transfer of a portion of their credits through an inverted lease, actually rethink the structure and contemplating, switching over to a partnership flip. And this is particularly in instances where projects may qualify for adders but haven't yet, and they're anchoring the tax equity commitment to a 30% ITC.

Julian Torres

David, I was a little surprised about the domestic content guidance indicating a sort of a penalty of perjury standard for certifying the claim for the adder, did that meet your expectations?

David Burton

Domestic content guidance is as clear as mud and is a bit of a nightmare. I've spoken to a lot of sponsors, a lot of developers, but I have yet to meet one or speak to one who says they think they qualify, or even if they can determine that they qualify, which is interesting because senators Wyden and Manchin are saying it is too liberal and too generous and too many people qualify, but I've yet to find anybody who thinks they qualify.

The penalties of perjury standard to certify? I guess that doesn't surprise me or it didn't surprise me because that's the same standard that applies to your tax return. So, it's not surprising to me that they used the same standard for the domestic content certification, but it does put particular pressure on getting that right.

I'm seeing some manufacturers say 'well look we've got 45% US content that's good enough you should be able to take the adder just knowing a manufacturer's domestic percentage doesn't come close to what the guidance requires. There's a huge gap between the rule Treasury made versus what manufacturers are prepared to do.

Domestic content guidance is as clear as mud and is a bit of a nightmare.

David Burton

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We can't lose sight of the fact that this policy objective has a date certain and that is to achieve carbon emission reduction goals by certain dates, because if we don't then bad things start to happen.

Julian Torres

Andrew Waranch

I'm meeting with suppliers all week. I have certainly found at least one who is willing to rep that they are domestic content, but they will not provide any supporting information or no cost breakdown due to proprietary restrictions. We are working through these types of obstacles each day.

Julian Torres

I feel like what we need is a trusted independent party that sees the information. I need to know that someone who's qualified to verify those claims has done that and has a balance sheet and demonstrated ability to pay if there's a claim.

What do you think about that? Are people or parties looking to set up such a mechanism so that we can actually transact on this?

David Burton

That there is one consultant who – apparently Canada had similar rules, and he did this for Canadian orders – whereby the manufacturers send him their cost information and then he does the calculation and he makes a certification to the project owner that it qualifies, but he doesn't disclose the cost information. So, he's kind of a black box and keeps it confidential, so that type of thing may be a solution.

I have no idea if this guy has the balance sheet that Julian referred to or if he's just an individual – somebody standing behind it is also important.

But you know the other thing about a manufacturer saying, 'OK, I'm going to certify my inverters for domestic content', well the test is applied at the project level so just knowing the inverter qualifies doesn't really help you because you need the cost to then plug that into your numerator and denominator for your whole project. Knowing one component qualifies, it's nice, but it doesn't let you actually do the necessary calculation.

Patrick Klein

I suppose if a creditworthy sponsor is the one making the rep, maybe that could be the balance sheet that backstops the rep and then you have the independent third-party expert making the certification, those two combined may get you to where you need to be.

Julian Torres

The general theme of this round of climate-driven expansionary incentives is democratization of energy. There's a huge element of energy and climate justice involved in these policies that really didn't exist before. And I think what we're talking about is just an element of the past where you had 'haves' and 'have nots', right?

The 'have nots' are creative developers, maybe not so creative developers, but you know those that don't necessarily have a balance sheet or the scale to get tax credits, right? And then they're selling their projects to aggregators and sponsors, who can then bundle projects to the capital markets to get the tax equity and access vendors and debt providers and so forth.

That greater scale that's more efficient – and that's not necessarily a bad thing – it imposes some discipline in the marketplace, but it also means that there is certainly a dead weight drag to the broader objective of having more deployment of clean energy in our grid and within a certain time frame. We can't lose sight of the fact that this policy objective has a date certain and that is to achieve carbon emission reduction goals by certain dates, because if we don't then bad things start to happen.

And so, I think there are certain elements of the policy that kind of create these outcomes that are not in line with the spirit of the overall objective, which is to make clean energy more accessible and



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to fix a lot of problems. New problems are clearly emerging in the implementation. I think this 10% adder is just one example of where things start to break down because to have the balance sheet to convince a lender that you can stand behind something as complex as this makes it that much more challenging to deploy with confidence.

Andrew Waranch

That's a space we've been in recently. There are a number of the developers and flip players who would sell products to us or partner with us because we could potentially access the tax equity markets more easily and provide a better balance sheet. We see this as a great partner opportunity where people can come to us. However, Spearmint is not an aggregator, but a potential pathway for smaller developers to partner, to bring development to fruition.

Importantly, you do need that local expertise. One of the topics we haven't covered much is the Energy Community adder. Recently I've been hearing more and more about the difficulty and how that will evolve over the next five years and, certainly, what effect that will have on recapture. Looking forward, I think there will be more projects qualifying for the Energy Community adder than the domestic content adder for sure.

There are a number of the developers and flip players who would sell products to us or partner with us because we could potentially access the tax equity markets more easily and provide a better balance sheet.

Andrew Waranch

David Burton

I mean the energy community rules are far from perfect, but they're actually workable, they're actually feasible to apply. They actually have some practicality to them, which is kind of the opposite of the domestic content rules.

Where I'm seeing issues with energy communities is on PTC deals, if you don't qualify for what they call the special rule, meaning you began construction after 2023. So, if you have a PTC deal that began construction last year or earlier, you then have to test for eligibility every year and that's going to depend upon unemployment in the particular statistical area and who knows what that's going to be.

So, it's very much year by year for those PTC deals, you can't really count on it, if you're in the fossil fuel employment category. It's different if you're closed coal mine or closed coal fired plant, that that's more locked down.



PFR: On the ITC and PTC, Spencer, I know at the start you said that you are taking advantage of one more than another. Can you tell us in more detail about the conversations you're having with clients?

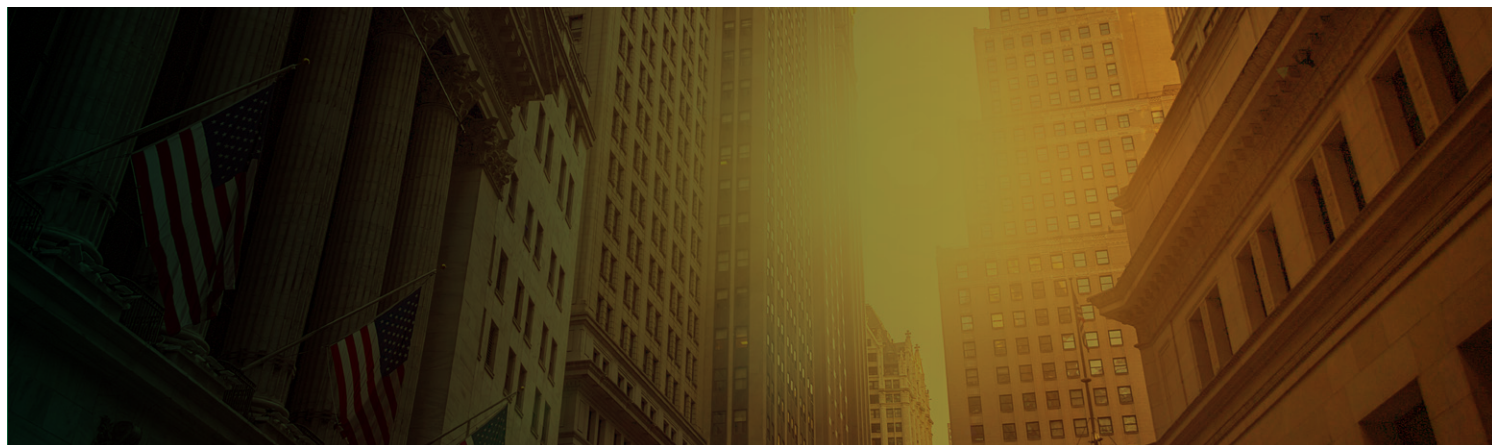
Spencer Tweed

So we view transferable PTC's as less risky because of that reduced risk of recapture. Like I was saying before, where we've seen variants across investors around how we're structuring transferability of the PTC, it is on the commitment tenor. There's a lot of interest that five years, but it's been a lot harder to get a full 10-year commitment. So, there's different sort of structures we've been exploring, maybe some sort of bridge loan product will start to appear eventually, but we haven't seen that in the market quite yet.

Spencer Tweed

I can say from a tax equity position and a structuring framework, you know, we've gotten comfortable with energy community adders and our base case underwrite. But as David pointed out on the gap between the rules issued by Treasury and what manufacturers are willing to certify on the domestic content adder, we're continuing to size-up front investments to the base case ITC and then including mechanisms to pay for adders once we've gotten comfortable.

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Julian Torres

I'm very encouraged by some of the more fundamental elements. The inclusion of certain interconnection costs in what's eligible for qualifying projects is very interesting. I think there are still some unknowns in how to determine eligibility for that, but I also think the expansion of the battery as its own standalone, eligible, qualifying facility is very important and I'm sure Andrew has his own views on this, but I can tell you we are excited as a company that specializes in incorporating multiple generating and storage assets, behind the meter, behind a single point of common control in a microgrid controller, the ability to charge and dispatch that battery.

You have to be able to charge it potentially from a genset, from solar or from the grid, to ensure that the resiliency is there, that the state of charge and readiness is there. Previously, you couldn't qualify that type of configuration for an ITC and have a product that you know your customer really wants.

So, for us as a modular microgrid company this is somewhat transformative because the market and capital stack is now caught up to where we are technologically.



PFR: Andrew, do you have a have a take on the battery side?

Andrew Waranch

Listen, I thought that without the ITC, batteries were economic in a couple of places, but that with the ITC batteries could be economic in virtually every state. If you look at the various forecasts, they predict that between 100GW and 400GW

of batteries will come online in the next 10 to 20 years. We estimate it to be the middle to high end of that range. A lot of it is going to be determined by the step-up value.

Revenue stacking happens in ISOs to solve grid resiliency problems. However, to solve those problems you need batteries, which can take three years to build from start to power generation. So, if a region has another problem they might just continue to add revenue, hence the stacking. You get into cycles where you might have to add 3/4 new series of revenues plus the ITC, but the effects won't come to fruition until three to four years later. I can't help but think back to 1997 when practically no new generation had been built in the US for a decade and then in five years, we built 225GW of gas-fired generation. I kind of feel like that's going to happen again here except this time we have the tax credit. I expect that the size and scope with respect to batteries is going to be shocking to people.

Also, as a standalone storage developer, one of the areas to me which was lacking the most was overall information on standalone storage, various placed in-service dates, and other components relative to solar plus storage. I think I think that much more guidance needs to be issued in that topic.

David Burton

We will get some of those answers when we get the Section 48 energy property regulations. The IRS has been working on since 2015, we're now expecting them in the third quarter, but it's been eight years so don't hold your breath.

But we're hopeful to have those in the third quarter. And I think when those come out, they will answer some of the storage questions.

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Andrew Waranch

And that is definitely impacting current transactions. I can tell you for sure.

I think the IRA has helped to the level the playing field for the various technologies and various solutions as we go through the US energy transformation.

Patrick Klein

Patrick Klein

I just wanted to add on to what Julian was saying. I think that taking a step back and looking at the overall impact of the IRA and all of the various incentives, new technologies, and adding the ITC for standalone storage has removed – what I think Julian's word was – the perverse incentive.

I think the IRA has helped to level the playing field for the various technologies and various solutions as we go through the US energy transformation. I think that the options for solving the puzzle of how we navigate through energy transformation have been improved by the options that have been opened up by the IRA. As we try to continue to build out solar and wind and deal with the intermittency of those resources, having batteries as a viable piece of that puzzle allows us to achieve the goal of further decarbonizing, which I think is an important part of what we're ultimately after here.



PFR: Let's discuss the expectations with regards to risk and return. Spencer I'll direct that to you first.

Spencer Tweed

I just like to make a quick point going back to the beginning of the conversation, we were discussing the supply constraints in 2023. I think one thing that's been really interesting is among our investment partners, there have been instances with investors who made commitments in 2022, pre-IRA, to 2023 projects assuming a 30% ITC.

And now that those projects are qualifying for adders, these investors are upsizing their investment into their existing obligations, rather than seeking opportunities elsewhere. A lot of the deal making, at least on our end, that's been going on in 2023 has actually been reconfiguring and rejigging existing commitments between our investors and our development partners.

I think moving into 2024 transferability continues to be at the top of our minds. There's been a lot of outreach on the marketing side to try and bring new folks into the space. Foss is active in the mar-

ket every day, having conversations with financial institutions, banks and insurance companies and corporate investors. And we've seen a number of folks who have historically been uninterested in tax equity because of the complexity of the structuring, be very interested in transferability. So, there's a lot of education there and I think that we will see a number of new entrants coming into the space over the next few years as transferability gains traction.

What is the return profile for our investor base? It depends, is the answer. I will say we have some investors who are participating as tax equity who are IRR driven, others who are more ROI driven. But then on the transferability side, I think we're still a bit in in wait and see mode to see where the market shakes out. I do think that there will be a slight premium for PTC over ITC in terms of pricing as we move forward because of that risk around eligible basis – this allowance that I mentioned earlier.

Andrew Waranch

If I could just jump in. As a developer, the real key to me is the step up. We're talking to a lot of people who want to be in the credit business whether that's through a brokerage or aggregation business, whether acting as agents or making markets and connecting the dots. The biggest variance we're seeing is how much step up they will allow. Most of the buyers come from a solar world where they have appropriate step ups for that product that I don't believe are appropriate for standalone storage. Through third parties, we've encountered a couple of financial engineering solutions to achieving a higher step up and transfer. This could be the solution, but the key will be offering the ability to capture the fair market value of the battery combined with the credit.

Julian Torres

I mean it definitely is something that I think about every working day and non-working day and working night and non-working night. I think I had a dream about it this week, actually. It's hard to get away from right now and you know our board is very interested in it, our customers are very interested in it, because there's certainly a spectrum of knowledge in the marketplace.

The customers that are interested in our microgrids, oftentimes have become fairly sophisticated in their procurement of on or off-site renewable energy and understand the economics and dug into that. And so, they're really interested in the

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adders we're willing to bake into our price offerings, what we're not, how we're sharing risk. And it's a competitive marketplace. Every time, in my experience over the last couple of decades, there's an expansion of the incentive you get a lot of newcomers. And I think you're always kind of competing with that next guy who's just entering the market and willing to take a punt on whether they can actually deliver something that's going to be determined by policymakers first, the market second. You're competing with a lot of voices and the experienced voice of reason says 'wait and see' but that isn't very helpful in developing and acquiring customers. And so, the sooner we get the guidance, the sooner I can probably stop thinking about the 'what if' and more of the 'how' and 'when'.

I guess the other piece of this is, what are the lender expectations about how this is unfolding. Right now, there's a lot of uncertainty as to what's optimal on a go-forward basis and I wonder how that's being incorporated into the other pieces of structuring these deals? If you were to offer a term sheet today versus 12 months ago to a sponsor of projects at various stages of development or close to construction what would be different now versus then – aside from the fact that while we're trying to figure this all out, there's the banking market in massive amounts of upheaval?

Patrick Klein

I think your question is relevant with respect to the general kind of market evolution that's going on after the IRA. So what I would say is that we are seeing developers and projects that are ready to put the shovel in the ground and continue with their construction timeline, have already put in a lot of equity into the project, and have various reasons for wanting to continue to build, whether it's a PPA deadline or just good construction sense, but they don't have the ability to line up a committed tax equity investor right now. That's

still their plan because they want to have the benefit of the depreciation as well as whatever basis step up the tax equity structure provides, so that's still the planned route, but they don't have committed tax equity now. In the past pretty much the only viable solution was to have a creditworthy sponsor guarantee, but now with transferability there's an alternative to that sponsor guarantee that, although not the expected case, but rather a fallback case where the project's developer can say, "If we don't line up tax equity, we will go to the transferability market and sell our credit." And so, I think that the advance rates may not be as high as the traditional tax equity bridge loan and the margin may also be higher, as there is additional risk associated with what you could call a "transferability bridge loan." But I do think that there is a bank market developing in that space so that sponsors and projects can continue to build projects in light of this new way of effectively monetizing those credits.

To come full circle, I think that there's an additional, alternative financing option based upon transferability that can allow builders to achieve financial close and keep building with leverage rather than by injecting additional equity. I think it also makes sense that you could also build into that construct the ability to then effectively upsize the bridge loan portion of the construction financing to be sized based on the tax equity commitment when that gets executed.

Spencer Tweed

I'd like to just make a quick point from the tax equity perspective on the standalone storage step ups from our view. I think so long as developers have an independent appraisal supporting the step up and sufficient balance sheet to provide guarantor support – and there's some sort of tax credit insurance in place – I think you will start to see investors get more comfortable with step ups relying on the income approach in highly volatile markets.

To use ERCOT as an example. Energy volatility is expected to remain strong in ERCOT with the amount of solar and wind projects and the interconnection queue – which is expected to create these bigger spreads between on peak and off-peak hours. So that's a bit of an education that's taking place among our investor base. I think we are seeing more and more investors get comfortable with those higher step ups and standalone storage – not 200% but more than what you would see in solar.



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Julian Torres

ERCOT is so fascinating. The problems are often, in my view, probably of their own making. They choose to be an island and as a result the PTC is an externality in that market whereas everywhere else it's a force for good. But in Texas, when the wind's blowing strong and the load isn't there, then you've got these congestion periods, the storage isn't there yet, and so people are willing to continue to generate at negative prices to earn PTCs, compounding this effect now you've got really low cost and efficient, high productive resource solar projects that will start to elect the PTC. This just kind of exacerbates that issue.

David Burton

The other thing you see in ERCOT is that it prides itself on being a sort of a free market system, but it's not really because the politicians don't want prices to spike to the point where the market would actually take them. So now they're trying to – for political reasons – manage the pricing using storage in ways that really is not optimal, just to keep the prices from getting too high. While if they let the prices go to where the supposed free market would take them and then motivate more generation to come online it would deal with the issues. It is a very interesting segment of the country and something to keep an eye on.



To wrap up this discussion I wanted to ask for your outlook. If we are going to have this conversation again next year, are we going to be talking about the same things or are there different issues that we expect to emerge?

Julian Torres

If I could make my grand statement: the policy-makers generally, I think directionally got a lot right, more right than wrong. But what it's left us with is a transitional period that has been somewhat frustrating.

I'm really excited about 2024 and beyond where I anticipate we will be past a lot of the fundamental gating items.

But I will recall that the transition from placed-in-service date dependent tax credit outcomes to begun-construction-dependent tax credit outcomes took several years and several rounds of notices. I'd definitely encourage policymakers



to be very receptive to the needs of the commercial market participants because that's the tip of the policy spear, that's where things actually get done. I think no one's looking necessarily for some free handout arbitrage per se. It's really just about having the policy tools to go out in the market, achieve the objectives and build great businesses that have a lasting impact.

Spencer Tweed

I think next year at this time, we'll be discussing the evolving marketplaces in the transfer space and the standardizing market structure and pricing that I think will take a bit longer to evolve.

Andrew Waranch

I think that there will be a diverse number of platforms, brokers, aggregators, offering everything from quick and easy transfers to more complicated structures. And you'll see a much clearer price for credit and just varying mechanisms to achieve that.

Patrick Klein

I'm optimistic that the conversation next year would be materially different. Rather than speculating and predicting, we will hopefully be more focused on what has gone on over the course of the past year and discussing how much the market has grown. Has it exceeded what we perceived as its current limits? A lot of people are excited about the opportunities that the IRA brings, but there hasn't been necessarily the level increased level of activity quite yet just because it takes time for a lot of things to take effect. I hope next year we'll be looking back and talking about how things have evolved and hopefully be observing how things were able to ramp up relatively quickly once guidance was issued. ■