

# Energy Finance

## Current Topics in Energy Finance

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# The Inflation Reduction Act

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# Tax Incentives for Tax-Exempt Entities

Potential to touch many government activities – NOT just public power!

- Transportation
- Affordable Housing
- Energy efficiency programs
- Water utilities
- Universities
- Not-for-profit healthcare

Direct payments allow municipal entities to claim:

- **Investment Tax Credit (ITC)**: upfront subsidy of project costs for renewable energy
- **Production Tax Credit (PTC)**: a subsidy over time based on power generated

IRA's incentives have changed the discussion about renewable projects from contracts with a developer to municipal ownership

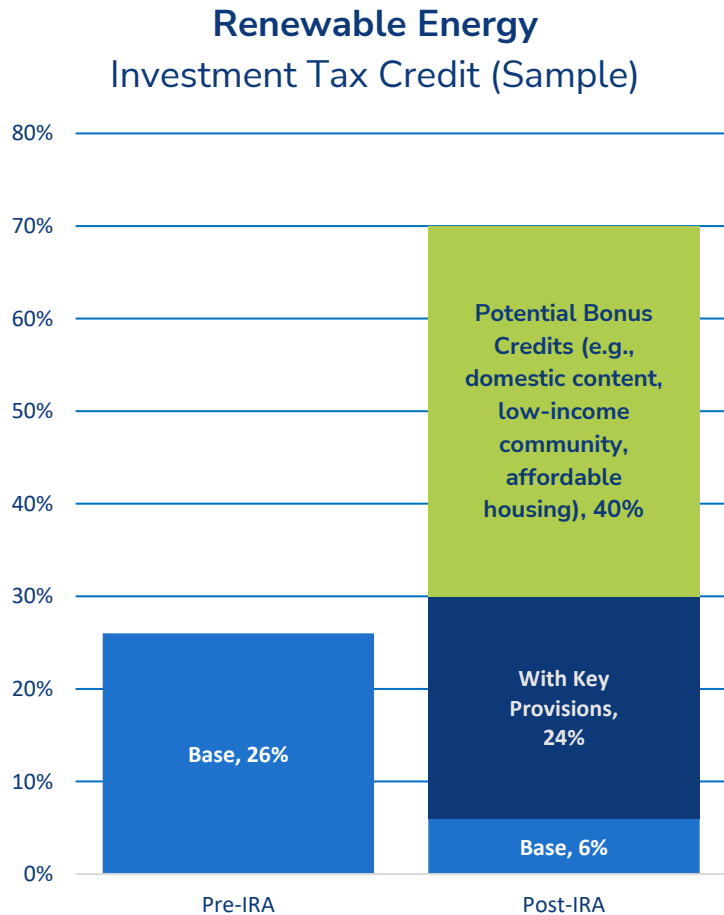
“Gross-up” provision to prevent sequestration (not tested by courts though)

# Tax Incentives – Before & After the IRA

	<b>Pre-IRA: Solar Developer Builds &amp; Owns</b>	<b>Under IRA: TE Entity Builds &amp; Owns</b>
<b>Tax Credits</b>	Solar Developer receives 30% of eligible costs	TE Entity receives 25.5% of eligible costs*
<b>Financing</b>	Solar Developer secures at private cost of capital typically with a “Tax-equity” partner	TE Entity secures at lower cost of capital
<b>Construction Risk</b>	Solar Developer responsible	TE Entity responsible (or contractor)
<b>Decisions at End of Useful Life</b>	Solar Developer controls	TE Entity controls
<b>Additional Considerations</b>	<ul style="list-style-type: none"> <li>• Pricing of contracts not very transparent</li> <li>• Unknown efficiency of depreciation benefit</li> </ul>	<ul style="list-style-type: none"> <li>• TE Entity’s lease versus own strategy</li> <li>• Reporting &amp; filing requirements</li> </ul>

\*Assumes the tax-exempt entity elects the ITC, meets the Fair Wage & Apprenticeship Requirements & finances the balance of the project with tax-exempt debt. Determining the most efficient incentive requires project specific analysis.

# Tax Incentives – Before & After the IRA

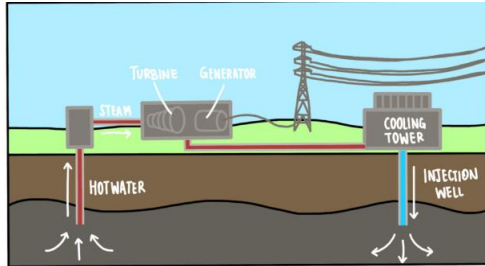


- Many of these incentives existed prior to IRA passage
- Tax-exempt entities now qualify
- “Base” benefit is significantly enhanced under the IRA if meeting “key provisions”:
  - Fair Wage
  - Apprenticeship Program
  - Domestic Content
- “Bonus” credits available for projects that can provide an *additional 10%* incentive

\* Assumes the tax-exempt entity (TE Entity) elects Investment Tax Credit, and other projects (>1MW) meets Fair Wage & Apprenticeship requirements. Determining most efficient incentive requires project-specific analysis.

# Tax Incentives 101 for Renewable Energy Projects

## Production Tax Credit (PTC): \$27.50 per MWh



- Incentive based on the energy produced from renewable facility
- Received annually for first 10 years of operation
- Requires annual filing with US Treasury and IRS (amount of energy produced from facility)
- Adjusted for inflation each year so maintains buying power
- Assumes the project meets key provisions; can finance with tax exempt debt, but incentive reduced by 15%

## Investment Tax Credit (ITC): 30% of qualified costs



- Incentive is based on the installed cost of the renewable energy facility
- Received once the facility produces energy and is interconnected into the respective grid
- Requires initial filing with the US Treasury and the IRS (the qualified costs as well as engineering reports)
- Assumes the project meets key provisions; can finance with tax exempt debt, but incentive reduced by 15%

Sources: Inflation Reduction Act, Congressional Research Service, "Tax Provisions in the Inflation Reduction Act of 2022", August 10, 2022 (<https://crsreports.congress.gov/product/pdf/R/R47202>). PTC reflects inflation adjustment for 2023 (<https://home.treasury.gov/system/files/136/Fact-Sheet-IRA-Equitable-Clean-Energy-Economy.pdf>).

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# Inflation Reduction Act – ITC or PTC?

## Investment Tax Credit:

- Qualifying Costs
- Payment Processing and Getting Paid
- Completion (supply chain, interconnection)
- Asset Ownership versus Power Purchase Agreement
- Project development

## Production Tax Credit:

- Generation Performance
- Dispatch in an Organized Market
- Counterparty Performance for a decade
- Adhere to “fair wage” & apprenticeship requirements for a decade
- Payment Processing and Getting Paid



# Case Study: Prior to Inflation Reduction Act

**Issuer:** Joint Action Agency (“the Agency”) supporting 50+ communities

**Goal:** Deploy solar resources in supported communities

**Plan:**

- City provides land to the Agency
- Agency builds solar facility
- Prior to commercial operation of the solar facility, the Agency sells the solar facility to a taxable entity
- Taxable entity claims tax benefits (state and federal incentives)
- Agency purchases project in Year 6/7 once tax benefits exhausted

**Result:**

- City receives renewable energy at a lower cost compared to a traditional contract through a Power Purchase Agreement
- Agency eventually retains ownership of the asset
- Local solar asset

\* Assumes the tax-exempt entity (TE Entity) elects Investment Tax Credit, meets Fair Wage & Apprenticeship requirements & finances the balance of the project with tax-exempt debt. Determining most efficient incentive requires project specific analysis.

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# Case Study: Utilizing Inflation Reduction Act

**Issuer:** County

**Goal:** Deploy solar resources across County

**Plan:**

- County develops comprehensive solar deployment plan
- County issues two (2) RFPs
  - County owns smaller projects (<1 MW)
  - Developer owns larger projects (>1 MW)
- County applies for PTC/ITC for the smaller projects
- Developer applies for PTC/ITC for the larger projects

**Result:**

- County receives the IRA incentive for “easy projects”
- Developer takes risk of compliance for larger projects (>1 MW)
- RFP process enhances competition and “sharing” of incentive
- Lowers the cost of the renewable deployment for local solar

\* Assumes the tax-exempt entity (TE Entity) elects Investment Tax Credit, and other projects (>1 MW) meets Fair Wage & Apprenticeship requirements. Determining most efficient incentive requires project-specific analysis.

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# UAMPS: Carbon Free Power Project



- Dispatchable Zero Carbon Resource
- 462 MW Gross
- 65 Acres
- Dry Cooled
- 159 Total Staff (7 admin & 152 plant)
- 95% capacity factor
- IRA assumed benefit = \$2.7B



# Inflation Reduction Act – Considerations

**Identify and evaluate IRA incentives that may support the recent and/or planned projects**

- For solar (or wind, geothermal, microgrid, or biogas) projects:
  - Compare Power Purchase Agreements to any direct ownership
  - Compare Investment Tax Credit vs. Production Tax Credit alternatives
  - Compare the financial impact of using tax-exempt debt and lower incentive vs. taxable debt and higher incentive
  - Identify the location of “energy communities” in the regional footprint, if any
- For projects under construction, determine eligibility and track eligible costs that can be incorporated into a request (accountant attestation)
- Core competencies of developer versus municipal entity

# Inflation Reduction Act – More Considerations

Map census tracts that are eligible for the EV charging station tax credit

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Consider **accelerating** certain programs or projects in light of the step-down in incentives or more stringent requirements

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Consider **adding** programs or projects in light of the new incentives available

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Consider cross-cutting programs across departments to try to capture as many of these incentives as possible

- Identify opportunities to combine credits and increase credits
  - Identify any overlap in IRA and IJA incentives
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Review of grant funding opportunities in the IRA (not covered in this presentation)

# Inflation Reduction Act – Tax Considerations

Many of the facilities covered by the IRA may be “output facilities” under the Internal Revenue Code and Treasury Regulations:

- *“Output facility” means electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities.*

Output facilities financed with tax-exempt debt are subject to additional restrictions under the Code and the Regulations:

- \$15 million limit on private business use of electric and gas facilities under IRC §141(b)(4).
- USTR §1.141-7 contains special rules for:
  - Measuring the available output of an output facility,
  - The treatment of take-or-pay, take-and-pay and requirements contracts,
  - Excepting short-term sales of output, swapping and pooling sales, and sales of transmission service under open-access regimes from private business use restrictions, and
  - Allocating private business use to a specific facility or to an entire power supply system.

# Prepayments for Gas and Electricity

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# Prepayment Transactions

Municipal entities can issue tax-exempt debt to make a prepayment to a commodity supplier to purchase future supplies of natural gas and/or energy at a discount

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Municipal utility can reduce its costs by purchasing the future supplies of natural gas and electricity at a discounted price as well as diversify suppliers

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Municipal utility's obligation is generally limited to paying for natural gas or energy that is delivered

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In the event the transaction unwinds, the result for the municipal utility is the loss of potential savings and a return to the standard procedures for purchases of gas or electricity



# Prepayment Transactions – Tax Overview

## Special Rules for Gas Prepayments in 2003 Treasury Regulations

- Final regs permitted prepayments for natural gas and electricity
- At least 90% of prepaid gas or energy must be put to a qualifying use
- Qualifying service area is defined as an area in which service was continuously provided for five years, or as a service area as defined under state law

## 2005 Energy Policy Act

- Statutory safe harbor for gas and energy prepayments
- Requires a 95% qualifying use test rather than 90% test
- Usage is based on historic sales rather than actual sales
- Includes a continuing compliance aspects
- Two year “true up” period for private use

**Regulations allow transactions to start with natural gas deliveries with future option to substitute to electric energy at purchaser’s option**

# Prepayment Transactions

**Energy prepayment transactions can provide significant savings to a municipal utility's ratepayers**

- Amount of savings may vary based on market timing
  - No guaranty of savings in future reset structures
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**Favorable risk allocation/mitigation**

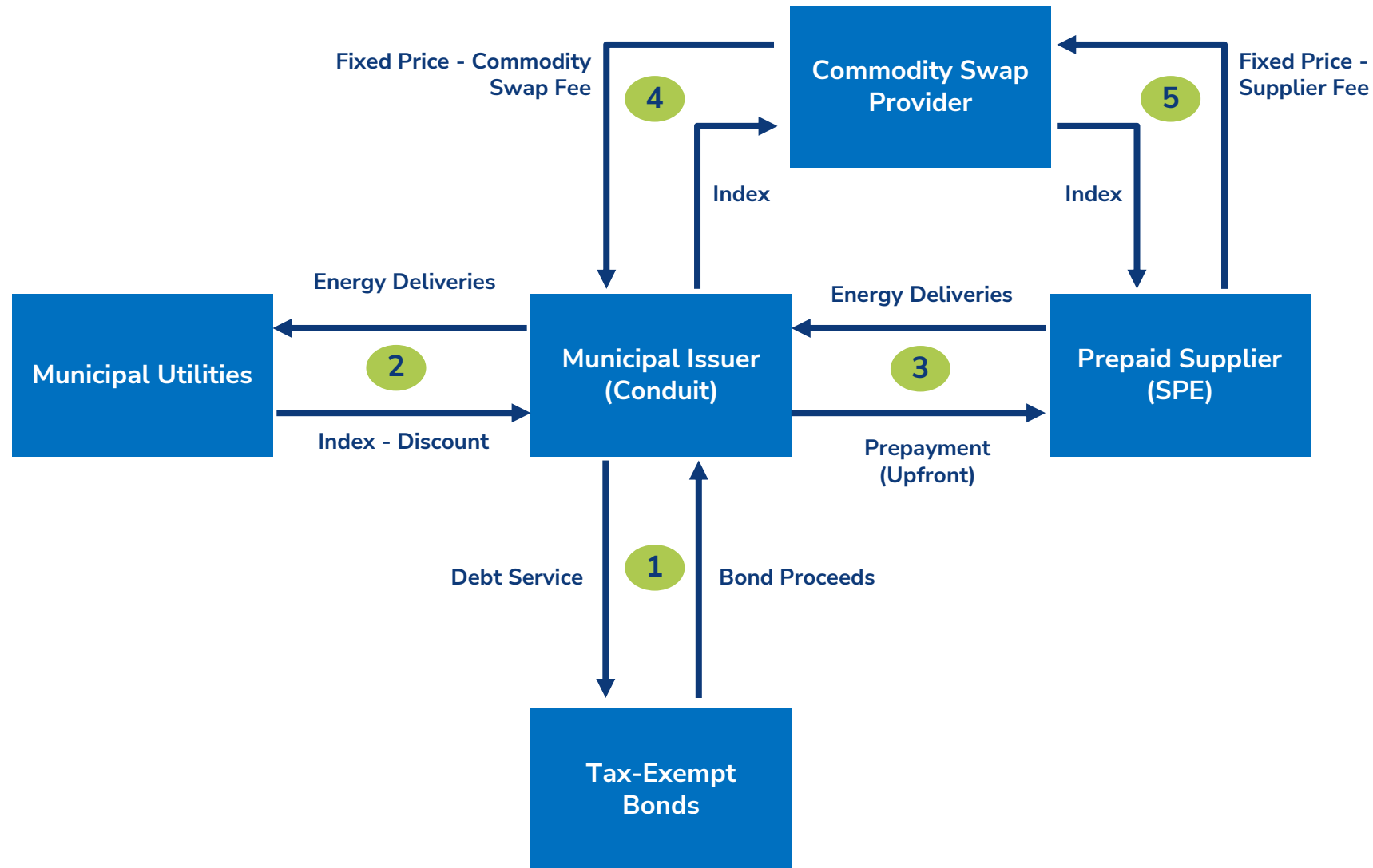
- Municipal utility's obligation is limited to paying for gas or energy delivered
  - No obligation to pay for the Issuer's debt
  - In event of delivery default, worst case is loss of savings and return to standard procedure for purchases of gas or electricity
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**Use of conduit issuer, choice of supplier & underwriter important**

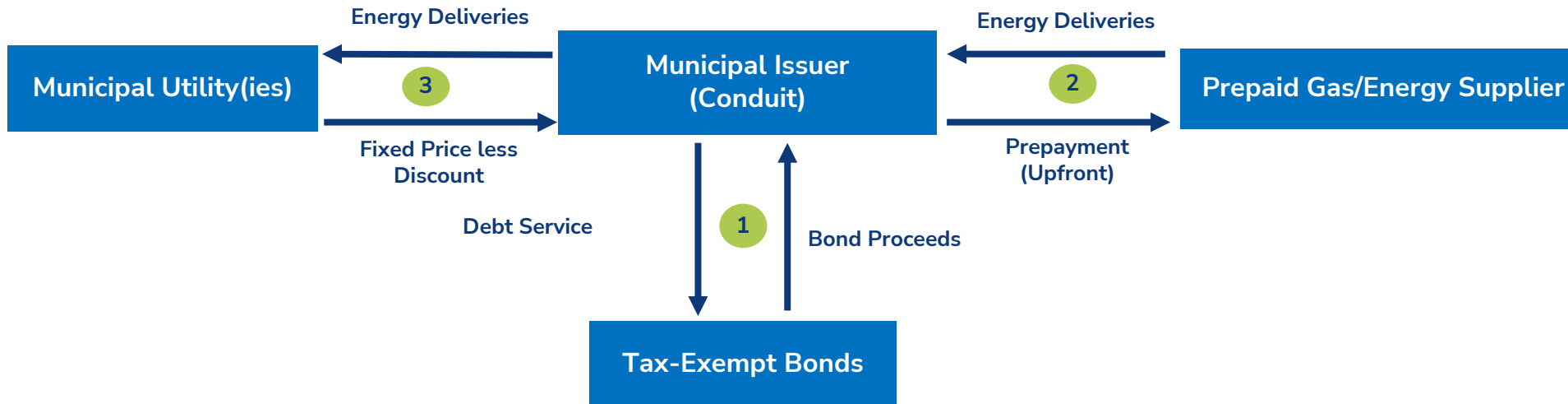
- Less work if use a conduit issuer but requires payment of an ongoing administrative fee which can reduce the savings
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**Complex transactions**

# Prepayment Transactions – Basic Structure

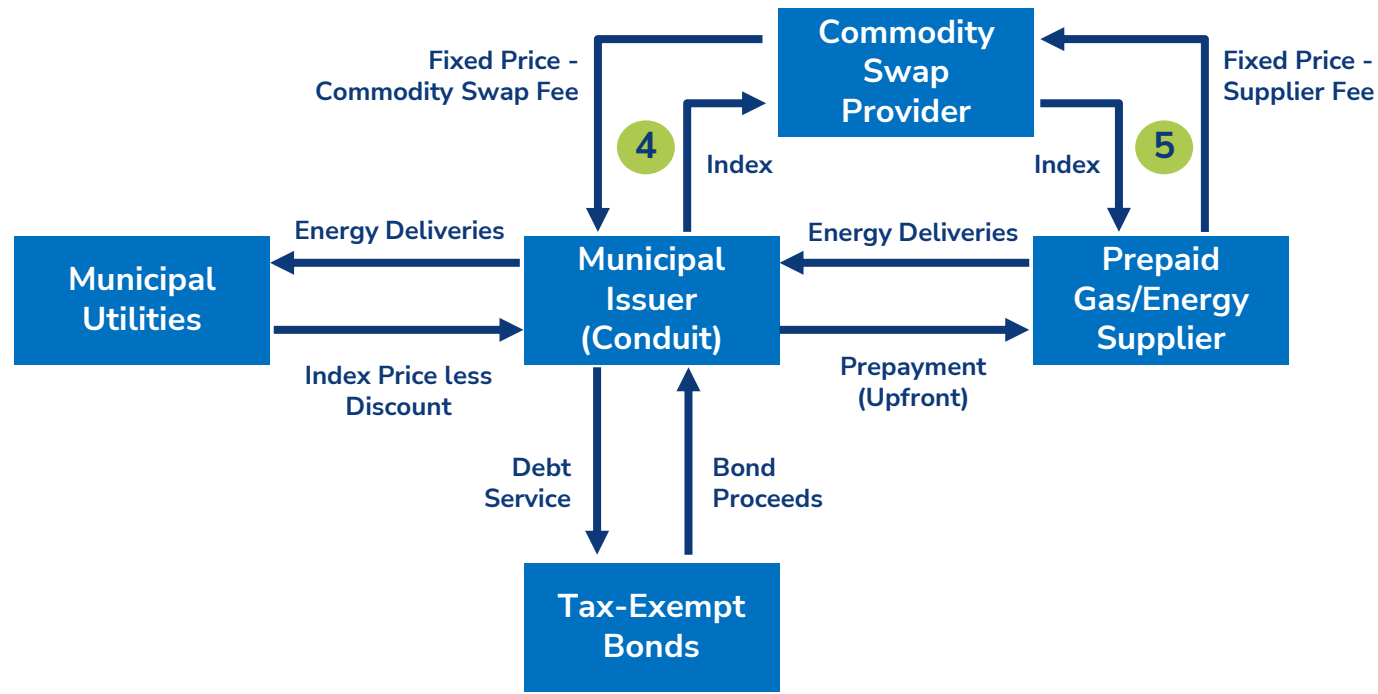


# Prepayment Transactions – The Prepayment



- 1 Debt Issuance:** Municipal Issuer issues tax-exempt bonds to finance a prepayment for 30 years of energy deliveries. The bonds are subject to mandatory tender at the end of an initial interest rate period (5-10 years) and are then refunded/remarketed in a new interest rate period at new interest rates.
- 2 Prepaid Energy Purchase Agreement:** The Issuer enters into a prepaid energy supply agreement with the Gas/Energy Supplier – Supplier agrees to deliver specified daily or monthly quantities of gas or energy over the term of the Prepaid Energy Purchase Agreement.
- 3 Commodity Supply Contract:** Under a Commodity Supply Contract, Issuer agrees to sell to Municipal Utility(ies) 100% of the gas or energy delivered by Supplier on a pay-as-you-go basis at a price equal to the applicable monthly market index *less a discount*.

# Prepayment Transactions – The Swaps



## Commodity Swap Contracts:

- 4 Issuer Commodity Swap** – The Issuer enters into a floating-for-fixed commodity price swap with an independent commodity swap provider to convert its floating energy sales revenues to a fixed revenue stream.
- 5 Supplier Commodity Swap** – The Gas/Energy Supplier enters into a mirror image commodity price swap (fixed-for-floating) with the same commodity swap provider to provide a floating revenue stream that enables it to meet its payment obligations to the Gas/Energy Supplier under the Prepaid Energy Purchase Agreement.

# Issuer's Prepay Experience - UAMPS

## Horse Butte Wind Project

- Developer of a 57 MW wind project in southeastern Idaho; 23 participating members of UAMPS under take-or-pay power sales contracts
- UAMPS sold the project to a special purpose entity (SPE) formed by an investment bank before commercial operation date (COD) in 2012
- On the COD, UAMPS issued tax-exempt bonds to make a prepayment to the SPE for 20 years of the P99 output of the project, and the SPE applied for the cash grant in lieu of the ITC that was available under Recovery & Reinvestment Act; the combination of the prepay and the cash grant substantially reduced the per MWh cost of the project for our members
- UAMPS exercised its early buyout option and re-acquired the project in 2018

## UAMPS New Prepay Project

- Developing a project to enable prepays for natural gas used for electric generation and renewable electricity under power purchase agreements
- UAMPS negotiates the gas and power purchase agreements with suppliers and developers, and then assigns them into the prepay structure
- Ability to switch from natural gas to electricity over time

# Considerations

## Amount of Gas/Electricity; Qualified Use

- Qualified volumes for a prepay transaction require gas or energy to be used for existing historical service territory
- Failure of gas or energy to be used for “Qualified Use” can result in early termination of the transaction or a reduction of amounts of energy to be delivered and a corresponding retirement of bonds

## Timing/Amount of Potential Savings

- Amount of savings may vary based on market timing
- No guaranty of savings in future reset structures

## Use of “Switch” feature and whether to incorporate

- With notice, the prepay switches from gas to energy
- Important if renewable mandates limit or eliminate ability to use natural gas for qualified use in service territory

## Use of conduit issuer; choice of supplier and underwriter

- Less work if use a conduit issuer but requires payment of an ongoing administrative fee which can reduce the savings

## Complex; often level of communication with board is extensive

# Questions

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