Renewable Energy Financing Mechanisms and Incentives: What Can We Expect?

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While much attention has rightly been given to the expiration of the Section 1603 cash grant program at the end of 2011, there are other tax incentives for renewable energy that are also set to expire in the upcoming years. The decisions as to whether to renew these incentives will have a major impact on the future of renewable energy in the U.S. as these existing and new programs have been instrumental in sustaining investor and lender interest in the renewable energy sector, particularly in the wind and solar markets.

The main mechanism employed to finance renewable energy has long been to lower the cost of capital through the use of tax credits. The production tax credit (PTC) and the investment tax credit (ITC) are both given to eligible companies who either start certain renewable energy projects or invest in renewable energy equipment. Eligible companies with insufficient profit to utilize these credits typically then sell them as tax-equity to investors in order to finance their projects. Eligible companies or tax-equity investors receive a tax credit equal to 30 percent of the eligible costs associated with the renewable energy project.

Since the 2008-09 recession affected the tax-equity market in the same way as the rest of the economy, with far fewer tax-equity investors available, the Obama administration’s American Recovery and Reinvestment Act of 2009 (the Recovery Act) extended and modified existing tax incentives and also created new programs. New programs under the Recovery Act included the Section 1603 cash grant in lieu of the ITC, which, as the name implies, gave equivalent cash grants to eligible taxpayers who would otherwise qualify for the ITC as a means of making up for some of the damage to the tax-equity market. The program has been credited with fueling much of the equity investment in renewable energy projects between 2009 and 2011 by expanding the universe of potential investors and, in many cases, accelerating the timing of their receipt of governmental incentives.

In the past, there had generally been bi-partisan consensus in support of incentives for renewable energy. The tone was more one of compromise and in favor of doing what was in the country’s best interests without regard to political affiliation. Along those lines, incentives for renewable energy were seen as both economically and environmentally beneficial for the country.

However, since 2010, there has been a shift in tone towards the renewable energy market due, in part, to the upcoming presidential election. In addition, the failure of several solar industry manufacturers in 2011 who had U.S. Department of Energy loans or loan guarantees — most notably, the federal government’s loss of $535 million in connection with the bankruptcy of California-based Solyndra — has given renewable industry opponents the political cover to reject further funding or other potential governmental programs. What was once a policy topic where decisions were made based solely on the good of the
country has now become a topic that is more politically charged and therefore not as open to compromise or new policymaking.

From both political parties and even outside of Washington, there is still a long-term trend of support for renewable energy to remain part of the energy policy of the United States. In addition to economic and environmental benefits, renewable energy is seen as being beneficial for our national security and the reliability and diversity of the energy grid. Other factors that will lean in favor of increased investment in renewable energy are the retirement of coal-fired power plants and the lack of support for nuclear energy. Due to these factors, there will likely be increased investment in wind and solar in particular but also in other alternative energy sources, as well as in natural gas.

Although the tax-equity market has bounced back to some extent with the help of the Recovery Act, it has still not fully recovered to its pre-2008 condition. With the expiration of the Section 1603 cash grant, industry experts have predicted a 50 percent or more decline in the volume of tax-equity available to finance renewable energy projects, since the program has succeeded in leveraging over $23 billion in private capital over an estimated 22,000 projects in all 50 states. According to some experts, there will be a shortage in 2012 of about $3.6 billion given current projected demand for tax-equity investment. To make up this difference, one potential source of tax-equity may be private companies who continue to seek healthy, risk mitigated returns and who have a significant tax appetite rather than traditional tax-equity investors, which tend to be large institutions in the struggling financial sector. One expert estimates that the 500 largest U.S.-based public companies paid $137 billion in taxes over the past year. Investment made by just a small number of these corporate taxpayers would close the gap dramatically and may even spark continued growth in the renewable energy sector. Google and PG&E are good examples of such large institutions taking advantage of governmental incentives.

Like the 1603 cash grant program, the PTC is also set to expire on December 31, 2012. This looming expiration (coupled with the expiration of the 1603 cash grant) is already having an adverse impact on investment in wind project, which tends to rely on the PTC rather than the ITC. Current estimates are that investment in wind projects will decline by two-thirds if the PTC is not renewed in the near term. In a recent Navigant Consulting report, the authors concluded that the PTC has played a major role in creating jobs in the wind industry. Navigant estimates that with the support of the PTC, the U.S.-based wind industry can create and save 54,000 American jobs over the next four years, as well as grow the wind energy manufacturing sector by one-third, to 46,000 jobs.

While more innovative or experimental renewable energy technology is in large part financed through venture capital, in addition to government support, more established technologies and deployment of these technologies, such as wind and solar energy generating facilities, are more dependent upon financing from long-term investors and lenders. Extending the existing government incentive programs for renewable energy is important. But, perhaps even more important is a regulatory environment where rules are certain and not subject to change every year or two. Only in such a stable regulatory environment will there exist the kind of stable cash flows that are necessary for the private capital that will sustain the established renewable energy market.