

Solar Project Forecast Dims With Tax Credit Sunset

By **Keith Goldberg**

Law360, New York (September 9, 2015, 7:51 PM ET) -- The U.S. solar industry is enjoying a development boom with record levels of solar installation but the impending drop in value of the federal investment tax credit threatens to slow the momentum, with the utility-scale project pipeline in the biggest danger of drying up.

Industry group Solar Energy Industries Association issued a report Wednesday claiming the U.S. solar industry installed nearly 1,400 megawatts of generation capacity in the second quarter of 2015, the seventh consecutive quarter in which the U.S. added more than 1 gigawatt of solar installations and pushing total installations over the 20-gigawatt mark.

The investment tax credit, which provides an incentive equivalent to 30 percent of the initial cost of wind, solar and fuel cell systems, has played a big role. But the credit is set to drop to just 10 percent at the end of 2016, and investors in projects that aren't completed by that point won't be able to cash in on the full credit.

"I think the market will soon start, if it hasn't started already, turning away from providing tax equity to utility-scale projects that are not certain to be completed with a safety margin before the end of 2016," said Keith Martin, the co-head of Chadbourne & Parke LLP's project finance group. "People won't have trouble financing projects with a construction completion target of late September next year, but depending on the project and riskiness of the construction schedule, they may start backing away from projects that are expected to be completed later than that."

The deadline has pushed developers into overdrive. There is more than 5 gigawatts of utility-scale solar generation capacity currently under construction, according to the SEIA. However, they may start pulling back as the 2016 sunset approaches, experts say.

"There is a big rush to get projects started — frankly, the utility-scale projects that aren't into construction or having otherwise substantial progress are going to miss the window," said McGuireWoods LLP partner Michael Woodard, who does transactional work in the solar sector. "There will be fewer announcements of deals in the next six months or so."

A similar scenario has played out in the U.S. wind industry, where development historically ramped up, then ground to a halt when the federal production tax credit was allowed to expire. The American Wind Energy Association says the wind industry installed nearly 2,000 megawatts of generation capacity in the first half of 2015, thanks in part to the most recent one-year resurrection of the production tax credit

that lasted until the end of 2014. But that's still far below the 2,900 megawatts installed in 2012, the year before Congress embarked on a series of annual, last-minute restorations of the PTC.

However, experts say the solar industry is better positioned to avoid those extreme highs and lows if the ITC is allowed to sunset. For one thing, there will still be a 10 percent tax credit available in 2017.

"I think both developers and financing parties will still have an appetite for projects even with a 10 percent ITC," Wilson Sonsini Goodrich & Rosati PC tax partner Greg Broome said. "Obviously the economics of the projects will change, but there's still a fair amount of optimism that these projects would still be feasible."

Perhaps more importantly, the solar sector has a significant — and growing — distributed generation component, unlike the wind industry, which skews toward large, utility-scale projects. The SEIA report says residential solar installations have increased 70 percent year-over-year since 2010.

Residential solar isn't as reliant on tax equity investment as utility-scale solar, and therefore, not as reliant on the ITC, says Mayer Brown LLP partner J. Paul Forrester, who specializes in energy finance.

"Utility-scale solar is very much like wind, you're competing against wholesale grid prices for other technologies, including gas," Forrester said. "In residential solar, you're seeing competitive residential rates. The bigger issues for residential solar are things like net metering, installation and bundling."

Also, the Internal Revenue Service recently gave the residential solar market a shot in the arm **when it determined** that individual investors in a community-shared solar project can qualify for a 30 percent residential tax credit, commonly known as the residential ITC. Although that credit goes away completely at the end of 2016, the IRS' guidance could significantly expand the pool of potential residential solar users, including renters as well as homeowners who, for whatever reason, cannot install solar panels on their roofs.

Nevertheless, expect the entire solar industry to make a major congressional push to extend the 30 percent ITC beyond 2016. The industry was dealt a setback in July when the U.S. Senate Committee on Finance didn't include the ITC in the two-year tax extenders bill it approved.

If the ITC doesn't make it into the final version of the tax extenders bill, another option is convincing Congress to change the ITC's eligibility rules to mirror the eligibility rules for the PTC. Instead of projects needing to be up and running by the end of 2016 to earn the 30 percent credit, the solar industry is pushing Congress to allow projects to collect the 30 percent credit if they start construction by the end of 2016.

Previous legislative attempts at eligibility parity have stalled, and Martin says Congress doesn't view the issue as being germane to the tax extenders bill, so it would likely have to stand on its own for consideration.

Assuming the ITC's deadlines and eligibility rules remain the same, it could squeeze out industry players who rely heavily on tax equity, but experts say it won't cripple the sector, especially as the cost of solar power continues to fall.

"I think there's enough folks in the market and focused beyond 2016 that, regardless of what happens with the tax credits, they will still be in there," Woodard said.

If anything, the ITC's sunset could lead to consolidation within the solar industry, says Peter Weiner, who leads Paul Hastings LLP's environmental and energy practice.

"There's a lot of other equity and finance available," Weiner said. "The retrenchment of the ITC will give a competitive advantage to companies with deeper pockets and better balance sheets and a competitive disadvantage to those who don't, because of the cheaper access to capital."

--Editing by Katherine Rautenberg and Kelly Duncan.

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