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Clean Energy Developers Fret Over Trump Tax Reform Talk

By **Keith Goldberg**

Law360, New York (January 30, 2017, 3:50 PM EST) -- President Donald J. Trump's recent call to slash corporate tax rates has unnerved renewable energy developers, who fear significant cuts may stymie projects by decreasing the appetite for tax equity investments that have been their financial lifeblood, experts say.

Trump said last Monday that he wants to see the corporate tax rate, currently at 35 percent, cut to between 15 and 20 percent, after he pushed for 15 percent during his campaign. With the Republican-controlled House of Representatives having already floated a broad-based tax reform plan that calls for a reduction to 20 percent, a sizable reduction in corporate tax rates is now a distinct possibility.

It's also a possibility that could make it harder for renewable energy developers to secure enough financial support for their projects, experts say.

“There's a finite pool of tax equity out there, and the likelihood is as the burden on corporations goes down, there will be less supply of tax equity,” said Stoel Rives LLP partner Greg Jenner, former head of the U.S. Department of the Treasury's Office of Tax Policy.

That means certain developers won't be able to get tax equity financing, and the cost of tax equity for the remaining developers will likely increase, he said.

"If the amount of tax equity contracts as a result of a reduction in the corporate tax burden, the effect will certainly be a limit on the amount of projects that can get done," Jenner said.

Tax equity financing — in which renewable project investors gain the project's tax benefits in exchange for their investment — accounts for approximately half of the capital costs for wind and solar projects, according to Keith Martin, the co-chair of Chadbourne & Parke LLP's project finance practice. He said tax equity investors generally determine the size of their investments based on four benefits: the federal production tax credit and investment tax credit, the amount of cash received from the project, tax savings due to losses — depreciation — and taxes on the income they'll generate from the completed project.

“If the tax rate goes down, two of the four items are affected: The taxes from the losses will be smaller, and taxes they'll pay on their income will be smaller,” Martin said. “This will reduce the amount of tax equity that will be raised.”

The production tax credit, or PTC, for wind projects and the investment tax credit, or ITC, for solar projects are true tax credits — a dollar-for-dollar offset against total tax liability — and neither the Trump administration nor Congress has shown much desire to nix them before the PTC expires in 2020, and the ITC drops in value in 2019 and reaches its lowest level in 2022. Still, the credits' impact could be dulled if a reduced appetite for tax equity because of lower tax rates has investors making fewer and smaller deals, experts say.

“It could shift the balance of power between the developers and tax equity investors and give tax equity investors more leverage,” said Hogan Lovells project finance partner Edith Webster, who frequently represents renewable developers. “I think it's a chipping-away at the incentives.”

If renewable developers are unable to secure sufficient tax equity for their projects, they'll have to fill the financing hole with debt, which is more expensive, or plow more of their own cash into the projects. That will especially pinch smaller developers and ones that don't have operating projects that are already generating income, experts say.

"If you're a utility-backed developer with deep pockets, you're going to use more of your parent's cash or your own resources,” said Mayer Brown LLP tax partner David Burton, who leads the firm's New York renewable energy group. “If you're a private equity, lightly capitalized type of developer, you may have to look around and see where you can raise cash equity.”

Burton said developers are already starting to look to pension funds, sovereign wealth funds and infrastructure funds to supply cash for their projects, though the tax-exempt status of some of those entities raise tax issues of their own.

Ultimately, smaller developers could be squeezed out, according to Mayer Brown tax partner Jeff Davis, who co-leads the firm's renewable energy group.

“I think one byproduct of the need to start construction by the end of last year to receive the full PTC and the possibility of tax reform is that we might see more consolidation of developers or early-stage developers flipping projects sooner,” Davis said. “There's now a limited universe of projects eligible for the full PTC in the wind space."

Many questions must still be answered before the renewable sector can gauge the full impact of corporate tax reform, starting with whether Trump's tax goals can be reconciled with the tax plan floated by the House.

Not only does that plan envision a cut in corporate tax rates, but it also contemplates tax law changes such as not allowing companies to recover costs from imported goods and services, which experts say could be a major financial hit for renewable developers given the number of solar panels, wind turbines and other equipment manufactured outside the U.S.

There are also questions over whether any tax cuts will be offset by any broadening of the tax base or shifting liability to different corporate sectors, according to Jenner.

“The big question is not tax rates, it's tax liability and who bears that tax liability,” Jenner said. “Does the burden of the current pool of tax equity investors change?”

House Speaker Paul Ryan, R-Wis., said Wednesday that he hopes to have a tax reform bill ready to be considered by August, though experts say that's a pretty ambitious timetable. Even if a bill results in a significant reduction in corporate tax rates, it's still uncertain how large a financial bite it would take out of renewable developers, experts say.

According to Martin, there was about $11 billion in tax equity financing available last year for wind and solar projects, but about 40 percent of that financing was from three large banks: JPMorgan Chase & Co., Bank of America Corp. and U.S. Bancorp.

“Because they're such a large share of the market, I don't know if they have any constraints,” Martin said.

Still, the specter of broad tax reform and lower corporate tax rates is already having an effect on renewable developers and their investors, experts say.

"One thing we're starting to see is tax equity investors assuming a lower tax rate after 2017 and 2018 and saying, 'I'm going to size my investment based on that lower amount,'” Burton said. “We're also seeing construction lenders, in deciding how much to loan, take into account where tax rates will be."

Investors are also pushing for greater protections against potential tax law changes in their agreements with developers, experts say. Examples include banks seeking indemnification from developers for income losses because of tax law changes and investors demanding the ability to redo the financial modeling that determines the size of their tax equity investment, or even halt funding, if there's a change or proposed change in tax law.

That could push developers to speed up the timelines of their projects while current tax rates and laws are in place, but there's only so much accelerating you can do with large, utility-scale wind and solar farms, according to Jenner. Besides, the tax reform genie is already out of the bottle as far as investors are concerned, he said.

“If something gets serious, these agreements are being negotiated in a way that allow the investors to come in and change the deal,” Jenner said.

--Editing by Christine Chun and Bruce Goldman.

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