Financing Wind Projects: The Impacts of Federal Incentives and the MISO Interconnection Process

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Overview

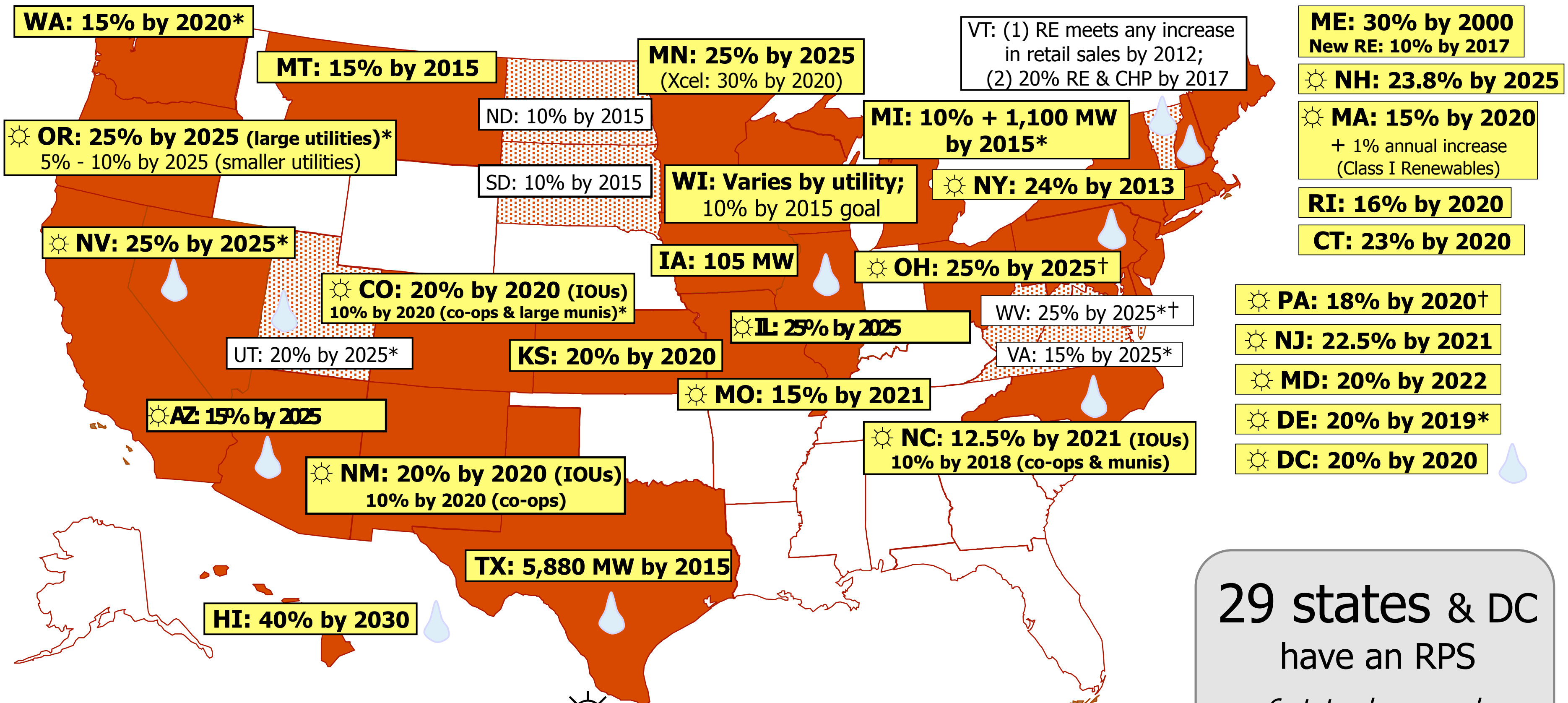
- Market drivers in the wind industry
- Key federal incentives
- Impact of incentives on project structure
- Impact of MISO interconnection milestones on financing

Market Drivers for Wind

- Renewable Energy Standards
- Federal tax incentives, grants and loan programs
- Threat of future carbon tax/regulation
- Utilities' desire for predictable long-term energy prices

Renewable Energy Standards

www.dsireusa.org / November 2009



29 states & DC have an RPS

6 states have goals

State renewable portfolio standard

State renewable portfolio goal

Solar water heating eligible

☼ Minimum solar or customer-sited requirement

* Extra credit for solar or customer-sited renewables

† Includes non-renewable alternative resources

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Federal Tax Incentives

- Accelerated Depreciation
- Production Tax Credit (PTC)
- Investment Tax Credit (ITC)
- Cash Grant in Lieu of ITC

Accelerated Depreciation

- Investment in wind project assets is recoverable using a 200% declining balance methodology with a first year half year convention that results in recovery as follows:

Year	1	2	3	4	5	6	Total
	20%	32%	19.20%	11.52%	11.52%	5.76%	100%

Production Tax Credit (PTC)

- Provides credit of 2.1¢/kWh
- Provides about 1/3 to 1/2 of the project's value
- Available for 10 years from date project is placed in service
- Wind projects must be placed in service by December 31, 2012.

Federal PTC

- Electricity must be produced by taxpayer
- Electricity must be sold to unrelated party
- PTC must follow revenue from sales
- Passive income restrictions apply

Investment Tax Credit (ITC)

- Wind project developers may elect to receive a 30% ITC in place of the PTC for facilities placed in service in 2009 and 2010, and also for facilities placed in service before 2013 if construction begins before the end of 2010.
- ITC subject to recapture for dispositions within 5 years of in service date.

Cash Grant

- The ITC may be converted to a grant from the Department of Treasury.
- The Treasury Department must pay the grant within 60 days of an application being submitted.

LLCs are Entity of Choice

- Pass-through PTC/ITC
- Pass-through accelerated depreciation
- Provide limited liability for owners
- Allow special allocation of depreciation and PTC/ITC

PTC and the Flip Model

Participants

- Landowners
- Developer
- Utility
- Investor

Key Time Periods

- Initial Term
- Flip Date
- Final Term

Tax Issues in a “Flip” Structure

- Partnership tax basics
- Subchapter K-flexibility to allocate profits and losses according to partnership agreement §704(a)
- Special allocations are the basis of the “Flip”
  - Special rules for special allocations

IRS Safe Harbor

- Developer's interest must be at least 1%
- Investor's interest must be at least 5%
- No purchase rights at less than Fair Market Value
- No guarantees of PTC or wind resource

MISO Interconnect Process

<u>Four Phases</u>

- Pre-Queue
- Application Review
- System Planning and Analysis
- Definitive Planning

MISO Milestones

- To enter DPP (M2)
  - D3 Deposit and
  - Any two of the following:
    - Documentation of application for state or local air, water, and land permits and that the application is proceeding per regulations;
    - Approval of the facility by a state utility regulatory commission;
    - Approval to proceed with the project from governing board;
    - Demonstration that generation turbines have been ordered for the generating facility; or
    - Security reasonably acceptable to the MISO equal to the requested gross nameplate capacity times the rate for one (1) month of drive-out point-to-point transmission service calculated on the notification date requesting submission of requirements to commence System Planning and Analysis Review.

MISO Milestones

- To enter Facilities Study (M3):
  - Security reasonably acceptable to MISO for the costs of Network Upgrades as determined in the SPA Review;
  - Execution of a contract for the sale of electric energy or capacity from the generating facility, or a statement signed by an officer or authorized agent of a utility attesting that the generating facility is included in an applicable state resource adequacy plan or other information that MISO deems to be reasonable evidence that the generating facility will qualify as a designated network resource; or
  - Demonstration that generation turbines have been ordered for the generating facility.

What's Known in Each Phase

- Pre-Queue – You're at the beginning, many are in front of you in line.
- Application Review -- You included the right info
- SPA – You're still in line, others are in line with you, there will be costs to interconnect
- DPP – Some have dropped out of line, estimate of costs +/- 20%
- Interconnection Agreement – Final costs and timeline – maybe…

What this means for Financing

- Significant dollars must be committed before total project costs are known
- Tax credit investor must be secured well *before* project is “construction-ready”
- Small and mid-sized developers without large balance sheets have more difficulty financing projects

Conclusion

- Federal incentives and tax regulations drive project structure.
- MISO milestones create new complexities and risks for financing wind projects.

Questions?

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