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FINANCING RENEWABLE ENERGY PROJECTS IN DIFFICULT ECONOMIC TIMES

INTRODUCTION

In most economic downturns, investors tend to flock toward the energy industry as a safe and reliable investment. This is no ordinary recession, and renewable energy projects have not been spared from the scarcity of capital. Despite the popularity of and public interest in renewable energy, investors are not standing in line with free-flowing capital for developers of renewable energy projects.

There are, however, financial incentives available to renewable energy projects that are not available to other projects. For example, federal and state governments have implemented programs and tax incentives aimed at sparking investment in renewable energy projects.

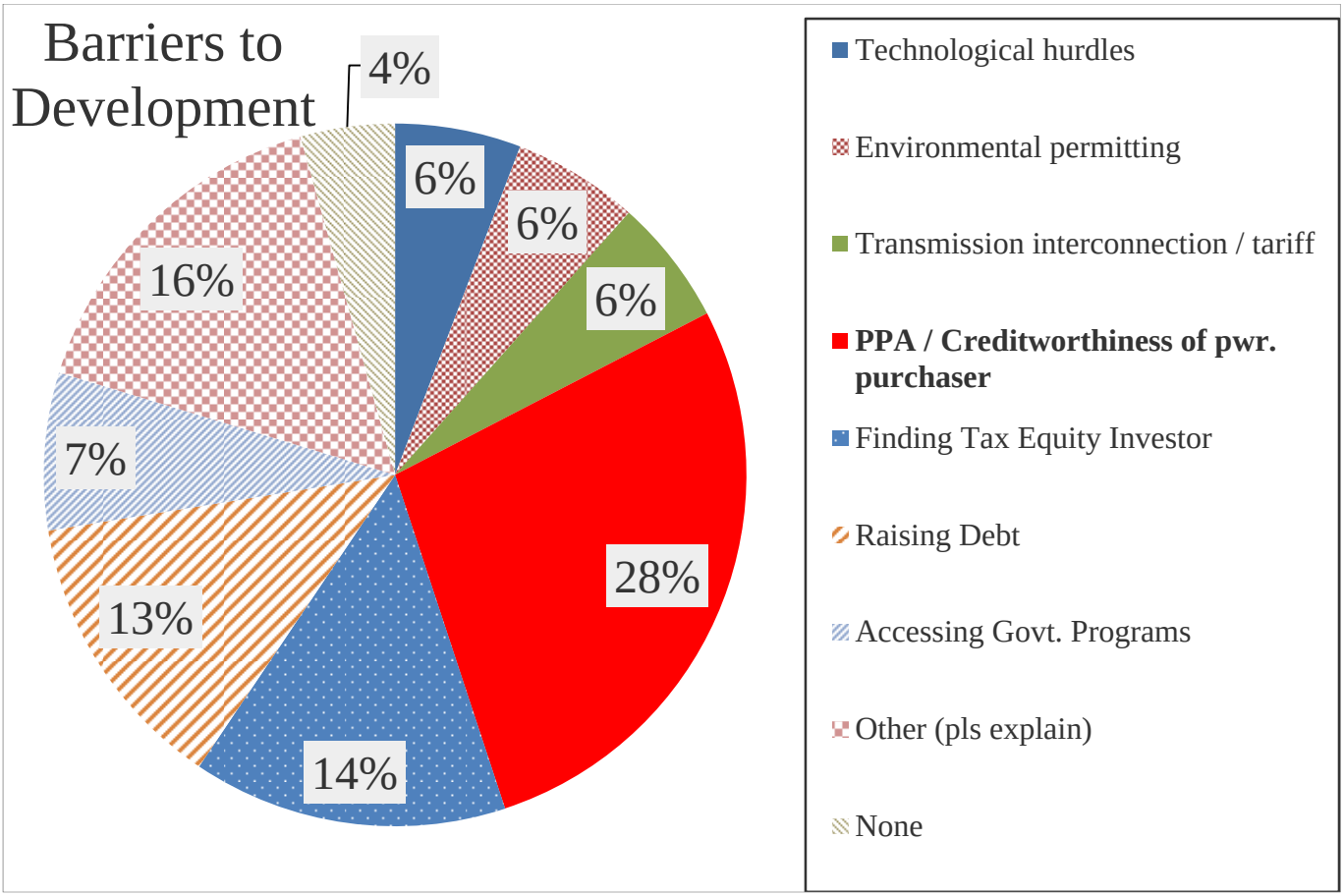


Figure 1 Source: NREL Renewable Energy Finance Tracking Initiative (Q1 2010)

FINANCING TECHNIQUES

While the financial arrangements of a successful renewable energy project can be structured in numerous ways, there are some techniques that have proven particularly effective. Developers can approach utilities that need renewable power and attempt to secure a solid power-purchase agreement or lease agreement. Lenders will view very positively the future cash flow from such agreements with a credit-worthy utility. In such cases, the lender may compensate the developer by reducing borrowing costs.

Developers may also structure transactions to involve tax-exempt or governmental entities, which usually have lower risk of default and thus more appeal to lenders and investors. These transactions may range from formal partnerships and joint ventures to leasing agreements and power purchase agreements. Developers should be careful in dealing with governmental

entities because most incentives come with rules designed to limit private benefit flowing from governmental entities. There are, however, ways to structure transactions to satisfy these rules and still qualify for the incentives.

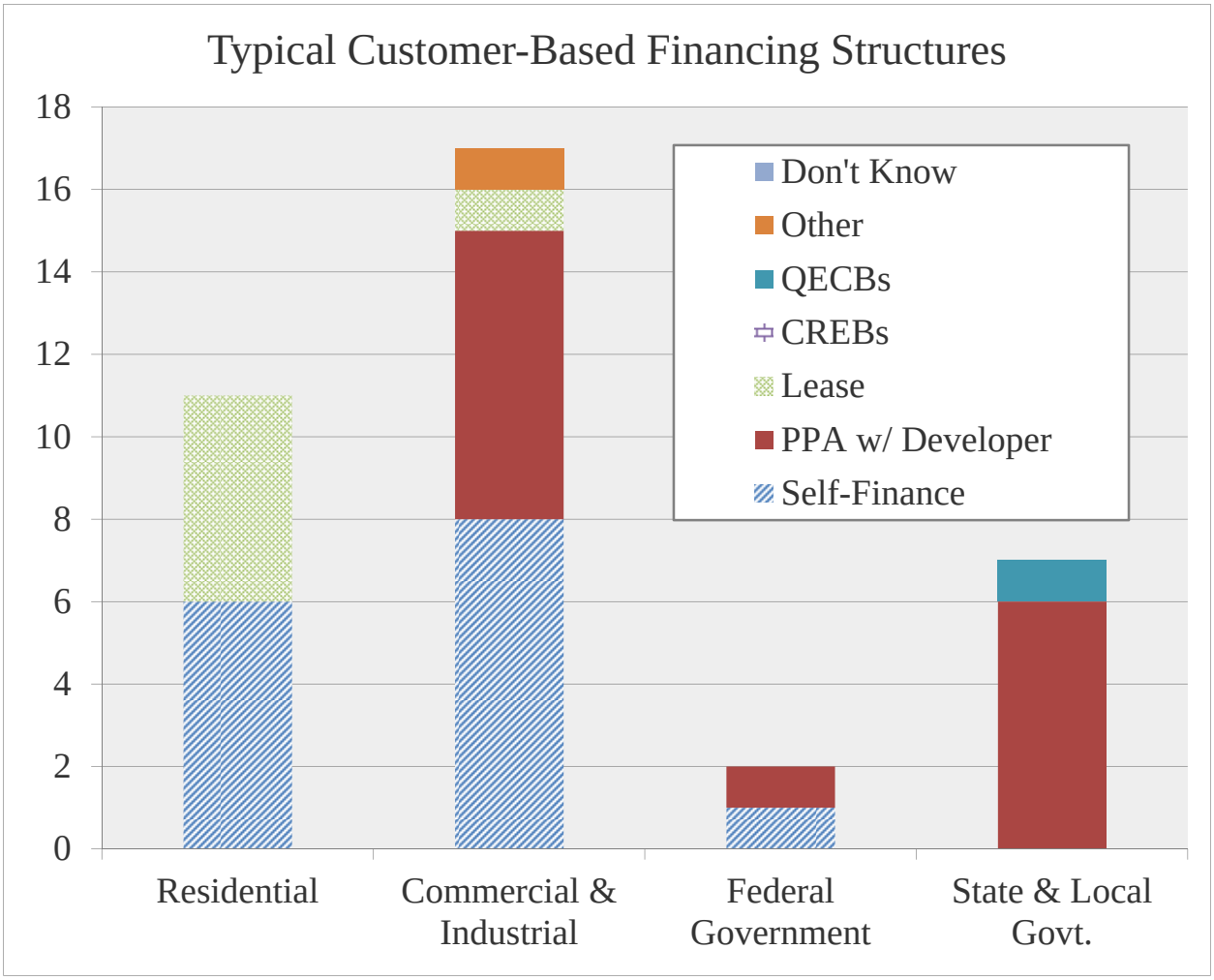


Figure 2 Source: NREL Renewable Energy Finance Tracking Initiative (Q1 2010)

GOVERNMENTAL INCENTIVES

Most renewable energy projects will qualify for some form of governmental incentive, such as grants, loans, loan guaranties, tax credits, or accelerated tax depreciation. The incentives usually have complex restrictions and deadlines, so developers must consult with legal counsel to determine the applicable parameters of each incentive.

American Recovery and Reinvestment Act

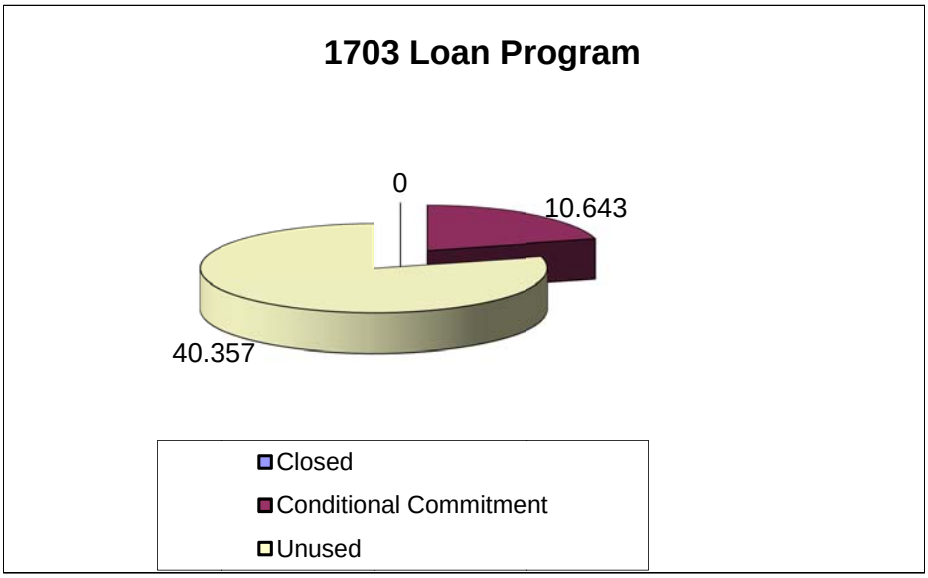
Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA") in part to stimulate investment in an assortment of industries, including renewable energy. ARRA included more than $42 billion in energy-related funding to be distributed through several government agencies. ARRA also provided $21 billion in tax incentives, primarily for the promotion of renewable energy. Most of these programs will sunset in the coming months unless Congress acts to extend or appropriate funding. ARRA funds should not be overlooked, however, because some programs may have remaining funds to distribute, some recipients may have been unable to utilize the funding, and some recipients may need to partner with developers with the technical expertise to make use of the funds.

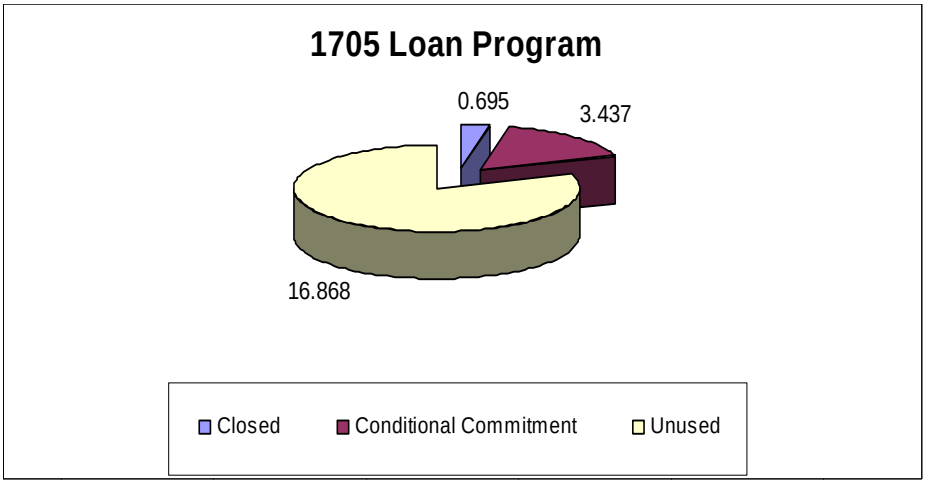
U.S. Department of Energy Programs

Loan guaranty programs maintained by the Department of Energy are designed to provide credit support for the development of clean energy generation and transmission. Two important programs, the Section 1703 and 1705 programs, were implemented through the Energy Policy Act of 2005 ("EPAct") and the ARRA.

The following charts indicate the DOE's loan authority under both the 1703 and 1705 Loan Programs.

Figure 3 Source: DOE LOAN AUTHORITY UNDER THE SECTION 1703 AND SECTION 1705 LOAN PROGRAMS (IN BILLIONS)





The ARRA also included $4.5 billion for "smart grid" projects consisting of electricity delivery and energy reliability activities to modernize the electric grid. Smart grid projects are generally intended to make transmission systems more reliable, more secure, "smarter," and capable of providing real-time information and interactivity for energy users, and may include improvements and upgrades in utilities' generation, transmission and distribution systems.

Small businesses are eligible to receive funding from the Small Business Innovation Research / Small Business Technology Transfer divisions of the DOE. These programs have provided funding – approximately $36 million in fiscal year 2010 – for various renewable energy technologies such as hydrogen, fuel cells, solar, geothermal, biofuels from cellulosic biomass, and wind energy sources.

U.S. Department of Agriculture

The U.S. Department of Agriculture provides funding for energy projects in rural areas

USDA United States Department of Agriculture

through its Rural Development Office (USDA RD). One of the USDA RD programs, the Business and Industry Guaranteed Loan Program, received $1.57 billion in ARRA funding to support guaranteed loans. Funding is available for equipment, real estate, and permanent working capital. The program is available for many types of rural-based businesses, but one of the specific allowable purposes is for the development and construction of renewable energy systems.

Another USDA program, the Rural Energy for America Program (REAP), provides grants, loan guarantees, and combination grant/loan guarantees for the purchase and installation of renewable energy projects by rural small businesses. Eligible renewable energy projects include wind, solar, biomass, geothermal, small hydroelectric, and hydrogen.

The USDA RD issues periodic notices of solicitation for applications for the program. Already, $70 million has been provided for the program for 2011 and 2012, with additional discretionary funding likely to be issued for each year.

TAX INCENTIVES

Two very important energy-related tax credits include the production tax credit (PTC) and the investment tax credit (ITC). The PTC is based on the quantity of renewable energy produced and sold during the first ten years of the project, commencing with the date the facility is placed into service. For the credit to apply, the project must be a "qualified facility" that produces and sells electricity to third parties. "Qualified facilities" include wind, biomass, solar, and municipal solid waste,

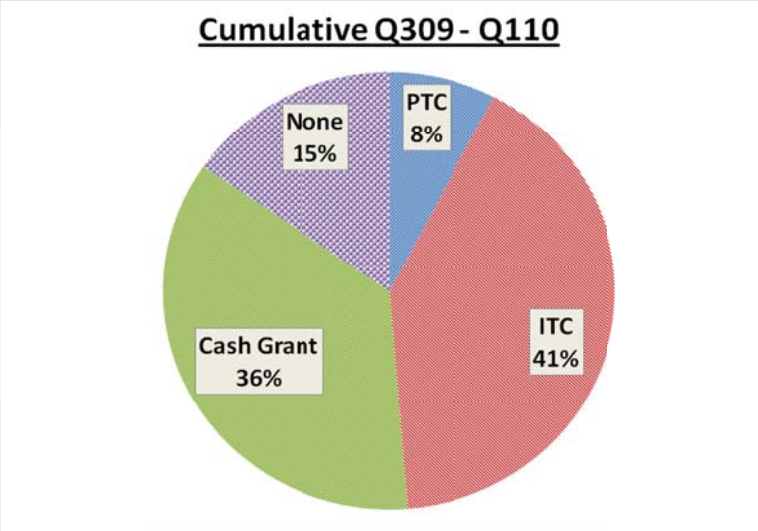


Figure 4 Source: NREL Renewable Energy Finance Tracking Initiative (Q1 2010)

among others. The credit is calculated by multiplying the amount of electricity sales during the taxable year (measured in kWh) by a specified inflation-adjusted amount, which in 2009 was 2.1 cents.

The ITC is available for certain renewable energy systems that include solar, fuel cells, small wind turbines (up to 100kW capacity), and geothermal systems. Eligible systems generally must be placed into service on or before December 31, 2016. The entity claiming the credit must construct the system or begin original use of the system before that date. The ITC is calculated by multiplying expenditures for an eligible system by the energy percentage, which is 30 percent for solar, fuel cells, and small wind turbines and 10 percent for geothermal and other systems.

Table 1: ITC ENERGY PERCENTAGES

Energy Property	Energy Percentage
Qualified Fuel Cell Property	30%
Solar Energy Equipment Property	30%
Geothermal Deposit Equipment	10%
Qualified Microturbine Property	10%
Combined Heat and Power System Property	10%
Qualified Small Wind Energy Property	30%
Geothermal Heat Pump System	10%
All Other Property	10%

The ARRA significantly affected use of the PTC and the ITC. One change allows facilities that are eligible only for PTCs to qualify instead for ITCs. The taxpayer who makes such an election will receive ITCs calculated using a 30% energy percentage. Owners of biomass, landfill gas, geothermal, hydropower, and marine and hydrokinetic renewable energy facilities placed in service from January 1, 2009, through December 31, 2013, and owners of wind facilities placed in service from January 1, 2009, through December 31, 2012, can elect ITCs instead of PTCs.

For additional information on energy tax credits and financing alternatives, see AHC's Resources page: http://www.ahclaw.com/subpage.php?section=resources

Table 2: PTC IN-SERVICE DEADLINES

Qualified Facilities	In-Service Dates
Wind Facilities	2009-2012
All Other Facilities: Closed-Loop Biomass Facility; Open-Loop Biomass Facility; Geothermal or Solar Energy Facility; Landfill Gas Facilities; Trash Facilities; Qualified Hydropower Facilities; Marine and Hydrokinetic Renewable Energy Facilities	2009-2013

This change can have a substantial impact on project financing because the ITC provides a larger immediate tax credit, as opposed to a lower tax credit spread over several years. Investors seeking to take advantage of tax credits would likely pay or invest a higher amount because they will no longer need to wait for several years to reap the expected tax benefit of their investment. The developer will also benefit because investors will likely apply a lower discount rate to monetize the expected future tax benefit. In any case, the expected financial effect of each alternative should be reviewed.

Section 1603 Grant-In-Lieu Program

Another significant change brought about by the ARRA is the grant-in-lieu program. Under this program, developers receive a cash grant generally equal to 30% of the cost of qualified facilities instead of the ITC or PTC. This program is particularly beneficial for renewable energy projects since developers of such

Table 3: SECTION 1603 PERCENTAGES

Specified Energy Property	Credit Termination Date	Applicable Percentage of Eligible Cost Basis
Large Wind Facility	January 1, 2013	30%
Closed-Loop Biomass Facility	January 1, 2014	30%
Open-Loop Biomass Facility	January 1, 2014	30%
Geothermal under IRC § 45	January 1, 2014	30%
Landfill Gas Facility	January 1, 2014	30%
Trash Facility	January 1, 2014	30%
Qualified Hydropower Facility	January 1, 2014	30%
Marine & Hydrokinetic	January 1, 2014	30%
Solar Energy Property	January 1, 2017	30%
Geothermal Energy Property	January 1, 2017	10%
Fuel Cell Energy Property	January 1, 2017	30%
Microturbine Energy Property	January 1, 2017	10%
Combined Heat & Power Energy Property	January 1, 2017	10%
Small Wind Energy Property	January 1, 2017	30%
Geothermal Heat Pump Property	January 1, 2017	10%

projects often do not have sufficient tax liability to make full use of tax credits.

To qualify for the grant, applicants must start construction by December 31, 2010, and submit an application to the Department of Treasury before October 1, 2011. Construction is deemed to begin when either physical work of a significant nature begins or pursuant to a safe harbor test, when more than 5% of the total cost of the property has been paid or incurred. The grants will expire with the credit termination date.

CONCLUSION

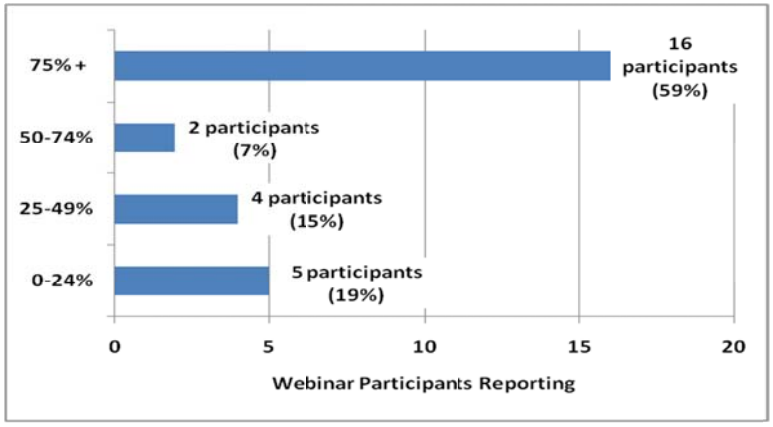


Figure 5 Source: NREL Renewable Energy Finance Tracking Initiative (Q1 2010); Percentage of Each Developers' Projects Dependent on Section 1603 Grant Financing

While traditional means of financing are not as prevalent as before the current economic downturn, developers should not be discouraged. Governmental incentives, and creative strategies to implement them, can substantially assist developers in securing the necessary financing for their renewable energy project. Developers must be persistent and investigate all avenues of potential funding.