NORTH AMERICA | TAX

Tax equity: dipping into the transfer market

The tax equity marketplace was forever changed in 2023 due to the emergence of transferability tax credit deals.

While written into law under the Inflation Reduction Act of 2022 (IRA), the power sector had been impatiently waiting for guidance on some of the fine print.

Succinctly, with transferability, instead of tax equity needing to invest in the actual renewables project — which is why it can be so complicated and only a limited number of investors are willing to do so — you can sell the IRA's tax credits.

In warmly received news by the market the US Treasury issued the highly anticipated proposed regulations for the transfer of certain income tax credits under Section 6418 of the tax code on June 14.

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For novice tax credit investors, transferability allows them to reduce their taxes and align with their ESG goals without tangling with complicated financial accounting or becoming project finance experts. While some banks, that are veterans of tax equity transactions, like transferability as the purchase of tax credits, unlike a traditional tax equity investment, does not attract a capital weighting charge and requires less time from underwriting teams.

In the wake of the guidance, transferability deals did ramp up, but maybe not in the way everyone anticipated.

"I think people still want to do tax equity deals and do a transfer deal inside a tax equity deal. It's those hybrid deals I'm seeing, and then they're trying to build flexibility into the partnerships to allow for that," said Ellen Friedman, partner at law firm Baker Botts.

This means that traditional tax equity investors are able to keep their options open and be able to sell credits at a later date.

"Nobody's straight up taking their credits— they are either signing up on day one that they have the ability to sell everything, or they're going to sell

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a set percentage," said Nicole Gambino, tax counsel at law firm Wilson Sonsini. "They at least want the flexibility even if they don't intend to sell today. They might want the flexibility down the road if they misjudge their tax capacity for instance."

In terms of pricing, the high watermark is 97 cents with low of 85 cents for transferability sales, according to multiple tax attorneys speaking to PFR. The highest publicly disclosed price was 96 cents, paid by Fiserv to First Solar at the end of December. The solar panel maker completed two Tax Credit Transfer Agreements (TCTAs) to sell $500 and $200 million in Advanced Manufacturing Production tax credits to the financial services company.

Yet, pure transferability deals seem to be the domain of newer market entrants and in deals where the tax credits have only recently been introduced by the IRA, technologies like renewable natural gas.

One flaw in the process is that the way the IRS wrote the guidance sellers of investment tax credits (ITC) are effectively blocked from selling their company, or selling equity in their company, for the next five years due to a recapture risk.

Under the recapture provisions, ITC can be recaptured if there is a "disposition" of the project within five years of its placement in service. The ITC vests incrementally over the course of five years. For example, if a project is sold, or experiences a casualty event in year two, then 80% of the tax credit amount that remains unvested must be repaid to the Treasury.

David Burton, a partner with Norton Rose Fulbright, explained that the proposed regulations confirmed that the buyer of the tax credit can be indemnified by the seller for recapture. Burton noted that tax credit buyers insist on an indemnity from a creditworthy seller or tax credit insurance, and that the market has yet to see an ITC transfer deal with project level debt as the ITC buyer does not want the risk of recapture from a foreclosure by the lender on the project.

"We've seen some interesting creative structuring around that, but it's not this kind of not consensus about that yet. Deals are getting done, but consensus is still kind of evolving," said Burton.

Brokering deals

And while traditional tax equity players are still active in the market investors of different sizes and sectors are now purchasing tax credits. Tax directors at some large corporations that have tax appetite have been early movers.

"I'm seeing a lot of transactions between big corporations with the tax departments driving it, which seems to work pretty well. They really understand the issues, they speak the same tax language," said Burton. "Some deals involve brokers, but a lot don't."

There are also syndicators or aggregators that are really active in trying to pick up some of the slack in the tax equity market and trying spoon feed deals to potential tax equity investors in exchange for a fee.

The big banks all want to be market makers in it too with many starting initiatives to originate and sell tax credits.

Also attempting to make life easier for would-be investors a number of other tax transfer platforms have emerged to connect buyers and sellers of renewable energy tax credits.

In September, Basis Climate launched its digital exchange, aimed to close transfer deals

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quickly, and closed a $100 million transfer of PTCs from a portfolio of wind projects (seller unnamed). Crux launched in April 2023, raising over $8 million in venture capital funding, and brought its platform, which connects developers, buyers, and intermediaries, online in September. And Evergrow completed the funding of a clean energy tax credit transfer on its platform in October.

"I think that those platforms are already proving to be playing a role for new buyers. It's not just about creating a software platform that runs online that people can click through. The creators of these platform are very thoughtfully carefully thinking about what the buyers and the sellers need. I'm very excited to see how those companies will help the transferability market grow and evolve," said Scott Zimmermann, partner at Wilson Sonsini.

Others were more skeptical of the role these platforms will play in transferability deals. The scenario the cynics presented was that the tax director of a major corporation is not going to wire $100 million through a platform and hope that they get a tax credit out the other side.

"I think they will probably evolve into more of an advisor with a tech enabled platform, but they ultimately are going to need to build out those advising capabilities to be able to walk these large groups through the process," said Bryen Alperin, managing director at tax equity investor Foss & Company.

However transferability deals are brokered the outlook for the market is strikingly positive even if some the path to efficient structuring is has not yet been trodden.

"I think we'll start to see more investors getting into the market in 2024. There's a number of investors that said,' yeah, we were interested in the transfer credits, but we don't want to be the first', they want to see how it plays out," said Alperin. "But I worry a little bit about the long term for the industry if some of these new buyers rush in a little too quickly and then they get they get burned on a deal. That might then ultimately lead to a pullback."

But, with transactions such as American Electric Power's (AEP) August sale of 1.365GW of wind and solar projects to a consortium of Invenergy, Blackstone, and CDPQ, Canada's second-largest pension fund, for $1.5 billion, will go a long way to making the market more comfortable.

Within the transaction was the first large-scale tax transfer agreement with the consortium agreeing to sell $580 million worth of tax credits to Bank of America. ■

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