DOE OFFICE OF INDIAN ENERGY

Pitching Your Project – Fundamentals of Finance to Make Your First Shot Count

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National Tribal Webinar Series: Pitching Your Project

U.S. DEPARTMENT OF ENERGY | Office of Indian Energy

Three Fundamental Basics of the Pitch

- If you are pitching a project concept to investors, they will need to know:
  - Is this the right management team, with the right experience, and the proper authority to pull it off?
  - Is the project sized and scoped correctly to make the financing work?
  - Can they understand the project fundamentals in an Executive Summary of no more than two to three pages?

Before We Jump Into Project Finance

- Resources for Funding, Technical Assistance and Renewable Energy Credits:
  - http://apps1.eere.energy.gov/tribalenergy/related_opportunities.cfm
- Federal Financial Assistance Opportunities At The Department of Energy (March 2003)
  - http://energy.gov/sites/prod/files/maprod/documents/finassthowto5.pdf

Economic Sovereignty and Project Finance

- Economic diversification is key to financial self-sufficiency for tribal governments
- Financing established tribal enterprises can be challenging; capitalizing a new venture is even more difficult
- Tribes that are pursuing diversification efforts should expect that initial capital will either need to be in the form of equity, OR
- Will require substantial support in the form of guarantees from existing enterprise cash flow or general obligation of tribe
- Will be extraordinarily expensive. Tribes looking to invest into new commercial enterprise would do well to plan to make a nearly 100% equity contribution, then work to find alternatives once the business has a proven cash flow.

Clean Energy Project Finance

- Majority of clean energy projects have been financed with a tax equity model
- Tax equity model is a combination of:
  - Small amount of sponsor equity,
  - Bank debt, and
  - Tax equity (monetization of tax credits)

Project Finance Basics

- Non-recourse debt, meaning the lenders do not have any other collateral except for the assets of the project
- Lenders loan to cash flows, and against assets (e.g., the panels, turbines, etc.)
- Loan repayment is from the project cash flows net of operating and capital expenses
- Project cash flows will provide scheduled debt repayment

Common Debt Structures

- General Obligation (GO) – promise to pay from all available moneys (backed by "full faith and credit")
- Unsecured GO: no particular revenue stream or bundle of assets secures the debt
- Secured GO: some revenue stream or bundle of assets pledged to secure the borrowing

Common Debt Structures, cont.

- Revenue Obligation – revenues pledged to secure the borrowing, but the general credit of the tribe is not (lenders have recourse only against that stream of revenues pledged)
- Asset-Backed – borrowing is secured primarily or solely by one or more specific assets; if borrower defaults, the lender can seize the property and resell it.

Some Bond Basics

- Bonds – more commonly used for long-term financing of larger, more costly capital improvement projects
- Longer term (up to 20 years) lowers annual debt service, but greater all-in-cost of financing
- Tax-exempt investors typically comfortable with longer term, smaller size (but may be slight premium on smaller deals, e.g. $10-15MM)

Some Tax Exempt Debt Basics

- Traditionally, tribal governments have been limited to issuing tax exempt debt only if proceeds of the financing would be used for an "essential governmental function"
- The IRS has interpreted "essential governmental function" very narrowly, excluding items that state and local governments can traditionally finance on a tax-exempt basis, such as hotels, golf courses, convention centers, event centers, parking garages, and related infrastructure

Tax Exempt Debt, cont.

- Private Letter Rulings for tribal energy treat debt as tax exempt
- The IRS has scrutinized several tribal tax-exempt financing transactions that state and local governments would traditionally have been able to finance on a tax-exempt basis
- As a result, tribes have traditionally been forced to either finance projects that would be tax-exempt for a municipality using taxable debt, obtain a PLR or leverage other funding sources

The Lender's Perspective vs. Equity

- Debt providers (banks and bond holders) provide more affordable capital but want little or no risk
- Lenders look for contracts that shift risk to someone with a deeper pocket and risk appetite (e.g., utility)
- Equity providers, by contrast, take the greatest risks but get compensated by getting all the cash available after paying project costs and debt

Lender's Basic Requirements

- Base case cash flow model showing debt will be repaid on schedule and the Debt Service Coverage Ratio (DSCR) requirements are satisfied
- A set of sensitivity (or reasonable downside) cases showing the impact on debt repayment and DSCR if things don't go according to the base plan
- Models must conform to the cash flow waterfall and DSCR covenants in the loan agreements

The Language of Finance

- Project team must be able to clearly forecast future cash generation performance, identifying key project and industry variables that drive those forecasts
- Finance is not simply accounting, which tends to focus on historical and current performance

Working Knowledge of Key Industry Factors

- Permitting and construction costs and timelines
- Technology costs and performance
- Operating costs
- Regulated utility allowable costs and revenues
- Merchant market price forecasting
- Sales and fuel contract review and interpretation

Credit Market Trends

- As the economy has improved, credit and capital markets have stabilized but in many areas credit is still very tight
- Strong tribal credits have access to less expensive bank debt
- Lenders providing loans to fund tribal enterprises are increasingly looking to tribal government as guarantor

Planning is Key

- Identifying the optimal financing structure to fund energy development should be based on a defined process and overall capital improvement or economic development plan
- Even if a tribe has sufficient funds to directly invest in a business opportunity, borrowing funds may allow the tribe to earn a higher rate of return on its money in investments elsewhere

The Project and the Plan

- Evaluate your project within context of overall capital improvement or economic development plan
- Understand these key issues:
  - Will the project generate revenues?
  - Will the project generate enough money to cover debt service?
  - Are there other assets of the tribe that may be pledged to improve financing terms?

The Goal of the Plan

- For Tribal Council and Tribal Members: illustrate, explain and justify the costs and benefits of pursuing an investment in tribal energy and the rationale for the proposed financing structure

Legal Issues in Financing

- Appropriate authorization pursuant to tribal law required for any borrowing (and corresponding waiver of sovereign immunity) to be valid, must be done in accordance with applicable tribal law
- Lenders' counsel now scrutinizing tribal law more closely
- Lenders usually want to specify a familiar body of law, such as law of state in which tribe is located or laws of State of New York, as governing law for the transaction

Supplementing Tribal Code

- Lenders may request that the tribe adopt certain laws or tribal code(s) compatible with state law, such as an arbitration code or Uniform Commercial Code to govern security interests in personal property

Who is the Borrower?

- Tribe
- Tribal Instrumentality/Authority (e.g. Tribal Economic Development Authority, Tribal Housing Authority)
- A political subdivision and unincorporated instrumentality of the tribe – not a separate legal entity from tribe
- Tribal Corporation
- Tribally-chartered corporation or federally-chartered under Section 17 of IRA
- LLC or other separate entity

Thank You!

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