Expanded Tribal Energy Development through Partnerships

Potentially Beneficial Partnerships with Investors

Presented By:
John Clancy
Key Reasons for Net Partnerships with Investors

• Tribes can often apply for and receive valuable grants for energy projects
  - e.g., DOE Tribal Energy Grants, Indian Community Development Block Grants, USDA REAP Grants, DOI IEED Grants for initial project development, state grants, utility grants, etc.

• However, especially for larger energy projects, grants typically cannot cover the full cost of energy projects.

• So key issue is financing remaining costs of projects.
Tax Credits and Other Tax Incentives can be valuable to energy and Other Projects

- Many Tribes and Tribal Housing Authorities have entered into partnerships with tax investors to take advantage of or to receive the benefit of low-income housing tax credits.
- By using similar partnership arrangements, valuable tax credits are also potentially available for wind and solar projects.
How Tax Credits Work in Indian Country

• Tribes and Tribal entities typically don’t pay income tax so they have to partner with the investors who do.

• The Tribe/TDHE forms a partnership with the investors for a limited period of time.

• The investor owns 99% of the partnership so that it can claim 99% of the tax credits that the Tribe can’t use. The investor also receives depreciation tax deductions on the equipment.
Key Business Terms

• Tax Credit: A dollar for dollar credit against income taxes otherwise due
• Depreciation: The right to deduct capital costs, over time, from taxable income
• LLC: Limited Liability Company: A partnership-like structure that allows for allocation ownership interests for tax purposes of profits and losses
Tax Credits

• The investor receives the tax benefits.
• The Tribe receives the investor’s cash to build the project.
• The amount that the investor contributes to the Project is negotiated. The investor is looking for a certain after tax return on the funds its invests.
• The value of the tax credits and depreciation may be large enough for both the investor and the Tribe/TDHE to benefit.
Tax Credits

Not all tax credits are created equal in terms of Availability;
• Complexity; and
• Value
9% Tax Credit – Hardest

“9%” Low Income Housing Tax Credits (“LIHTC”):

• Limited availability; Highly competitive application process administered by states; Some states have designed their LIHTC programs in a manner that excludes tribes (e.g. emphasis on urban areas)

• Very Complex – Application process very technical, High transaction costs; Ongoing state regulatory oversight for fifteen years;

• Value – Can deliver 70%+ of Total Development Cost
“4%” LIHTC:

• Generally available; No federal limit. Non-competitive application process. Awarded routinely with allocation of multifamily housing bond allocation from Washington State Housing Finance Commission.

• Medium Complexity – Tribe/TDHE must apply for multifamily housing bonds, enter into partnership agreement with investors; Ongoing state regulatory oversight for fifteen years;

• Value – May deliver 30%+ of Project Total Development Cost for non-solar housing and 15% of solar installation costs when combined with ITCs.
Investment Tax Credit

Solar and wind tax credits are typically easier than LIHTC because:

• No competition
• No application process
• No state oversight
• Delivers up to 30% of Project Total Development Cost
Solar ITC

The Renewable Energy Investment Tax Credit ("ITC"):

• Available for solar PV and thermal.
• Key is making it function like a grant for tribes.
• Delivers up to 30% of cost of development.
• Begins phase-out for projects that commence construction after 2019.
  - 26% in 2020
  - 23% in 2021
  - 10% thereafter
Wind Production and Investment Tax Credits

The tax credits, extended through 2019, have begun phasing down by 20 percent each year beginning in 2017:

- For the PTC, wind projects that started construction in 2015 and 2016 receive a full value PTC of 2.3 cents per kilowatt hour for 10 years. For projects that begin construction in 2017, the credit is at 80 percent of full value; in 2018, 60 percent PTC; and in 2019, 40 percent PTC.
- Similarly, for the ITC election for wind energy, projects that started construction in 2015 and 2016 are eligible for a full 30 percent ITC; for 2017, a 24 percent ITC; for 2018, an 18 percent ITC; and in 2019, a 12 percent ITC.
- The rules will allow wind projects to qualify as long as they start construction before the end of the period.
Use of Tax Partnership to Fund Wind and Solar Projects

- Potentially pay for large portion of project through Federal and other grant incentives.
- Utilize ITC or PTC value to fund or finance substantial additional portion.
- Utilize power purchase agreement (PPA), other energy services contract, or in some cases a lease arrangement to fund remaining costs of project.
- Likely have an opportunity for Tribe to purchase asset at fair market value and/or for investor to sell project at designated price.
- Take into account both net revenue from PPA or other arrangement and sale/purchase of asset in determining full funds that should go to investor.
Combining LIHTCs with ITCs

• ITC combined with 9% LIHTC can finance up to about 65% of solar system.
• ITC combined with 4% LIHTC can finance up to about 50% of solar system.
• TDHE cannot finance costs through PPA because LIHTCs don’t permit commercialization of financed improvements.
• Similar result, however, if the Tribe passes capital costs on to tenants in rent while reducing tenants’ monthly housing costs.
Combining ITCs with LIHTCs

e.g., Tribe defines “rent” to include tenants’ electricity costs.

Before: Tenant’s adjusted income is $1,000; tenant pays $90/mo. for electricity; TDHE charges $210 rent because of $90 utility allowance ($1,000 * .30 = 300 – 90)

After: Tenant’s adjusted income is $1,000, tenant pays $10 for electricity) TDHE charges $260 rent, gets an extra $50/mo. revenue.

Tenant’s monthly housing costs reduced by $30.
The Deal with the Solar or Wind ITC

Investor

The ITC is like Low Income Housing Tax Credits in some ways:

1. There’s an LLC or partnership with an investor.
2. The investor is given the ownership interest in order to claim the tax credits.
3. The investor compensates the Tribe for the tax credits by contributing equity to the project.
4. After a period of years, the investor goes away and the Tribe keeps the project BUT…
The Deal with the ITC Investor

1. The ITCs aren’t allocated by a state housing agency and the State has no compliance role.

2. The ITCs aren’t competitive and there’s no complicated application process.

3. The investor can claim the credit in year one instead of over 10 years.

4. The investor may be ready to exit after six years instead of 15 years.

5. Complexities of transaction often relate to energy/utility grant requirements instead of tax credit requirements.
Procurement-Related Documents

• Request for Statements of Intent from Indian-Owned Firms
• Notice of RFP Availability
• RFP
• RFP Proposals
• Evidence of Selection
Design-Build Contract

• Between LLC and Contractor
  The LLC, owned by the Tribe (1%) and the Investor (99%), enters into a contract with the Design-Builder to install the system.

• May be an AIA A141 Standard Form of Agreement Between Owner and Design-Builder.

• Issues include:
  − Federal Procurement Requirements
  − Subcontracting, employment and training opportunities for tribal members
  − Warranties
  − Commission requirements
Key Agreements: PPA

The Power Purchase Agreement (“PPA”)

• Determines what the Tribe or another entity will pay to the LLC for energy during the payback period.

• Needed to show LLC operated as a business.

• Could be less than what the Tribe or others currently pay to utility for energy.
PPA could be based on SEIA or other form

- Exhibit 1 (Basic Terms and Conditions)
- Exhibit 2 (System Description)
- **Exhibit 3 (General Terms and Conditions)**
  - Purchase/sale
  - Potential prepayment option
  - Maintenance and repair
  - System relocation and removal
  - Default, remedies, and damages
  - Ownership and option to purchase
- Exhibit 4 (Grant and Incentive Documents)
- Exhibit 5 (Contractors and Subcontractors)
- Exhibit 6 (Insurance)
Documenting LLC’s ownership and access

• Monetizing tax credits requires a lease or permit to establish the LLC’s control of the wind or solar facility for tax purposes.

• Lease: BIA Part 162 Leasing Regulations
  - Still Require BIA approval of all leases.
  - Leave in doubt whether agreements for installation and access are “permits,” “rights of way” or leases.
Related Agreements: Lease

- Monetizing tax credits requires a lease or permit to establish the LLC’s control of the facility for tax purposes.
- Lease: BIA Part 162 Leasing Regulations for restricted fee lands.
  - Still Require BIA approval of all leases.
  - Leave in doubt whether agreements for installation and access are “permits,” “rights of way” or leases.
Related Agreements: Lease

The HEARTH Act:

• Important 2012 sovereignty-enhancing act of Congress
• Permits tribes to avoid future BIA lease approval by adopting a BIA-approved leasing ordinance
• Includes Tribal Environmental Review Procedures
Related Agreements: Leases

HEARTH ACT

- Enhances tribal sovereignty by transferring control of leasing from BIA to tribes
- Reduces costs and delays relating to BIA approvals
- Encourages home ownership and economic development
- 25 tribes have BIA-approved HEARTH ordinances
Related Agreements: Permits

Permits avoid BIA approval process (just 10-day BIA review to confirm not a lease). According to 25 C.F.R. § 162.007, they generally:

- Do not grant a legal interest in Indian land;
- Are of shorter terms than leases;
- Give permittee has a non-possessory right of access, not a right of possession or right to “limit or prohibit access by others”; and
- Are revocable “at any time.”
LLC Organizational and Operational Documents

- Articles of Organization
- Operating Agreement
- FEIN
Operating Agreement

• Agreement between members of LLC (Tribe and Investor)
• Should provide credit to Tribe for grant funds (typically as capital contribution).
• Determines how to share tax benefits received by the investor (limit payments to investor, taking into account how sharing the value of the tax benefits).
• Management of LLC and actions of members:
  – Tribal Manager (control over project development)
  – LLC Manager (investor manager)
Other Potential Key Documents

• Service Agreement
• Development Agreement
• Tribal Resolution (regarding energy ordinance)
• Energy Ordinance
Post-Project

• Documents related to transfer of solar assets to Tribe:
  − Recognition of buyout
Thank You.

John Clancy
jclancy@gklaw.com
(414) 287-9256