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Eyeing Tax Rewards, Big Cos. And PE Firms Back Solar

By **Pete Brush**

Law360, New York (January 23, 2012, 5:51 PM ET) -- The end of a federal grant system that doled out billions of dollars to solar energy companies may have been a blow to some players in the industry, but still-remaining tax benefits are proving to be a strong enough lure for rich corporations and private equity firms to invest in solar projects, experts say.

The U.S. Department of the Treasury's 1603 Program grants, which died a well-chronicled death at the end of 2011, paid $9.6 billion to support renewable energy projects over three years.

The grant program's demise will make it harder for smaller solar players to finance major projects, experts say, because only big businesses that turn regular, taxable profits can realize savings under the federal tax incentive program, which has at least five more years of life.

Sensing opportunity, companies like search titan Google Inc. and private equity giant Kohlberg Kravis Roberts & Co. LP are making big moves into the world of solar investing. Not only will they realize the public relations glow that comes from investing in renewable energy but they'll also reduce their tax burdens.

Google and KKR recently announced major investments in a utility-scale solar project that will help power Sacramento, Calif., providing a major boost to the solar project's sponsor Recurrent Energy — which itself is owned by another corporate titan, Sharp Corp.

Technically, the timing of the Sacramento project allows it to reap grant money. And there are significant potential profits in solar energy. But, regardless of profit potential, the future tax benefits are alluring.

"We plan to continue investing in renewable energy projects," said Google spokesman Parag Chokshi, whose company has been making solar investments for some time now.

KKR is seeing a new dawn for solar too. The private equity giant took the Sacramento announcement as an opportunity to announce the creation of a new solar investment arm called SunTap Energy RE LLC.

Investors like Google and KKR will lay out potentially billions of dollars to fund big projects and, in return, will receive rebates on their federal tax burden not to mention local tax incentives, profits from energy generation and accounting benefits that come with asset depreciation.

A delighted Arno Harris, the CEO of Recurrent Energy, called the Google-KKR investment "an example of the direction solar is headed as a viable, mainstream part of our energy economy."

Other big players like GE Capital — General Electric Co.'s corporate finance arm — also are getting into the game and, according to experts, who predict that still more cash-rich giants like Apple Inc. also may be contemplating utility-scale solar project investments.

But hundreds of small solar companies that relied on the grants to get smaller-scale residential and business rooftop projects up and running — especially those that borrow against future revenue — will not be so fortunate.

“Smaller commercial and industrial projects will be hurt,” said Lee Barken, energy practice leader at accounting and consulting firm Haskell & White LLP. “The cost of capital from a tax equity project is higher than costs associated with applying to get a check from the Treasury."

Reasons why capital is more expensive in tax equity projects are manifold, experts say. The chief reason is that traditional tax equity players, typically banks, charge small solar companies high interest rates on capital that could be used for such investments.

The upshot is likely to be a hit to so-called distributed generation projects — the industry term for smaller projects including the installation of solar panels atop businesses, homes and universities that often are carried out by smaller solar businesses.

“A lot of those distributed generation developers relied on the cash grants. Now they're going to have to go to banks or other tax equity investors — and that makes the financing more expensive,” Phoenix-based Snell & Wilmer LLP business and finance partner Franc E. Del Fosse III said.

A perfect example of such a business is Palm Springs, Calif-based Hot Purple Energy, which competes for smaller-scale installations in California's Coachella Valley — a hotbed for distributed generation installations with many competing companies.

Hot Purple Energy president Nate Otto says the grants should have been extended and hopes they are revived.

“The expiration of 1603 is putting a damper on small commercial installations. It has been a deal killer already on a few of our jobs,” Otto said. “We do need the federal help. The oil and coal industries are still subsidized 100 years later. We're not looking for 100 years — but we'd take another 10 years.”

Otto says his business is competitive enough to survive but doesn't think every small solar installer in the Coachella Valley will be so lucky.

Echoing this view is the the Solar Energy Industries Association — the industry's biggest lobbying group — which says that the expiration of the grants will mean 37,000 jobs left on the sidelines in 2012.

Small- to medium-sized traditional solar players contemplating bigger projects are on notice too.

The Google-KKR foray into solar has sent shock waves throughout the industry, according to Al Nagy, the chief operating officer of PsomasFMG LLC, a regional solar projects developer based in Los Angeles County, Calif.

Nagy says the Google/KKR announcement has also triggered a scramble among solar players to partner up with their bigger cousins.

Nagy agrees with Otto that the expiration of the grants will weed out weaker players and will result a lower number of projects overall but says his company, which has paired up with NRG Energy Inc. on a 12-megawatt project and is busy looking for other partners, saw the end of the program coming.

“We wrote our business plan without the grants built in. The grants were a bonus,” Nagy said.

Experts also point out that getting a so-called tax equity play off the ground typically requires hiring an expensive legal team, not to mention accountants and consultants — not an easy hurdle for small solar outfits with thin balance sheets.

“It would probably be useful to have extended the grants — but there clearly are some private investors who are taking up the slack,” said professor Sara C. Bronin, director of the University of Connecticut's Center for Energy and Environmental Law.

--Editing by John Quinn.