Federal Tax Incentive Opportunities
Waste to Energy Projects
April 27, 2012
Agenda

› Renewable Energy Industry Drivers

› Overview of Federal Tax Incentives
  – Renewable Energy (ARRA)
  – New Market Tax Credits

› Tax Incentives’ Fit with Funding Options
Baker Tilly Virchow Krause at a glance

Baker Tilly is the 8\textsuperscript{th} largest accounting network worldwide

- 19\textsuperscript{th} largest in U.S. consisting of over 1,400 Professionals

- Virchow Krause established in 1931

- Eleven years as an established investment banking practice through Baker Tilly Capital, LLC

Baker Tilly Renewable Group U.S. Clientele

- Developers
- Public Entities / Utilities
- Manufacturing
- Real Estate
- Native American Tribes
Baker Tilly clients have completed or have ongoing renewable energy projects in the states shaded green.

1,500+ MW
55+ projects
> Wind
> Solar
> Biomass
> Anaerobic Digestion

Tax Credits/Incentives
> 1603 Grants
> ITC/PTC
> 48C Monetization
> New Markets Tax Credits
Primary Drivers of Renewable Energy

› Renewable Portfolio Standards (RPS) creating demand for renewable power
  – State level incentives
  – Renewable Energy Credits (REC) currently an inefficient market
  – National RPS has been proposed/discussed

› Financial Incentives for Renewable Energy Projects (ARRA most recent)

› Carbon emission regulations and offset markets creating economic incentives to reduce greenhouse gas emissions
  – EPA currently regulates CO2 emissions (fine based system)
  – “Cap and Trade” system has been adopted in California (October, 2011) creating a compliance market for carbon credits from agricultural projects

› Environmental regulations increasing – major impact on agricultural and food processing sectors relating to waste disposal processes
RPS Standards

Renewable portfolio standard
Renewable portfolio goal
Solar water heating eligible

Minimum solar or customer-sited requirement
Extra credit for solar or customer-sited renewables
† Includes non-renewable alternative resources

29 states + DC and PR have an RPS
(8 states have goals)
Net Metering Policies

Net Metering
www.dsireusa.org / October 2011

* State policy applies to certain utility types only (e.g., investor-owned utilities)

Note: Numbers indicate individual system capacity limit in kW. Some limits vary by customer type, technology and/or application. Other limits might also apply.

This map generally does not address statutory changes until administrative rules have been adopted to implement such changes.
Section 1603 Program Guidance defines several “Qualifying Facilities”. Most waste to energy projects qualify under one of the following:

- “Trash facilities: A trash facility is a facility, other than a landfill gas facility, that uses municipal solid waste to produce electricity…”
  
  “Municipal solid waste” is defined in IRC section 45[c][6]. By reference this term is defined in section 2(27) of the Solid Waste Disposal Act (42 USC 6903) as it relates to “solid waste”. This Act defines solid waste as “any garbage, refuse…and other discarded material, including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, and agricultural operations…”

- “Open-loop biomass facilities: An open-loop facility uses open-loop biomass to produce electricity. Open-loop biomass is any agriculture livestock waste nutrients or any solid, nonhazardous, cellulosic waste material or any lignin material that is derived from qualified sources.”
  
  Agricultural livestock manure and litter
  
  Qualified sources from which solid, nonhazardous, cellulosic waste material or any lignin material must be derived are:
  
  Forest-related resources
  
  Solid wood waste materials
  
  Agriculture sources, including orchard tree crops, vineyard, grain, legumes, sugar, and other crop by-products or residues
ARRA Tax Incentives

› Tax Incentives:
  
  – Production Tax Credit equal to $.011/kwh produced for 10 years (inflation indexed)
  
  – Investment Tax Credit (“ITC”) equal to 30% of eligible project costs
    
    » Eligible project costs are those related to “**Specified energy property**”, which is in turn defined as “**only tangible property (not including a building) that is an integral part of the facility**”
  
  – 1603 Grant in Lieu of ITC
    
    » Grant proceeds available 60 days after Commercial Operation Date (COD)
    
    » Project must have “commenced construction” by December 31, 2011

For PTC, ITC or 1603 grant, Project must reach COD prior to December 31, 2013

  – Accelerated Depreciation (5-7 Year MACRS) applies as well (basis reduced by 50% of the 1603 grant)
ARRA Qualified Facilities…

› Combined Heat & Power ("CHP") Facilities
  – System uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications):
    » Produces at least 20% of its total useful energy in the form of thermal energy, and;
    » Produces at least 20% of its total useful energy in the form of electrical or mechanical power, and;
    » Meets energy efficiency (at least 60%) and capacity (50 MW or less) standards
  – ITC is equal to 10% of eligible costs
  – Project must reach COD prior to December 31, 2016

Need to carefully plan and apply when thermal energy generation is involved. IRS has indicated that some thermal does not automatically cause a project to have 10% ITC/1603 Grant eligibility.
Structures Used for Tax Investment

› Structures
  – Sale-leaseback
    » Term of lease must be meaningfully shorter than useful life of equipment
    » FMV requirements
  – Flip Structure (Section 45, Revenue Procedure 2007-65)
    » Investor owns 99% of project, sponsor owns 1% but is managing member
    » Automatically shifts to 5/95 split at pre-arranged “flip point” (based on IRR for tax investor)
    » Sponsor has option to purchase remaining 5% at FMV
  – Preferred membership class for tax investor
    » Preferred equity holders would receive preferred return and their original capital in advance of distributions being made to the common equity holders.
    » Tax benefits from losses included in definition of “cash flow” for purposes of calculating distributions to preferred members

› Requirements in all cases
  – Must be investor at time qualifying equipment is placed in service (Sale-leaseback provides 3 month cushion)
  – Economic substance guidelines

Tax Investor will have similar underwriting perspective to senior lenders
New Markets Tax Credits (NMTC)
- Brings additional low cost capital to fund a project
- “Typical” NMTC deal ($10 million of allocation) provides approximately $2.0 million of benefit to the project
- Total allocation of $33 billion since program’s inception in 2000

Can be combined with renewable energy tax incentives
What are New Markets Tax Credits?

> First tax credit program to stimulate commercial investment in rural and “low-income communities”

> The program is administered by the US Treasury Department through a division called the CDFI Fund, in a unique “public/private partnership” with Community Development Entities (CDEs)
What is a “community development entity”?

> CDEs come in a variety of forms:
  - An affiliate of a municipality to promote economic development
  - An affiliate of a bank to help meet the bank’s community reinvestment goal
  - Non-profit and for-profit entities with a mission to serve low income communities

> CDEs have defined geographic service areas and are charged with evaluating each potential NMTC transaction for community impact

> CDEs can be found using a search engine on the CDFI Fund website at www.cdfifund.gov
Community Development Entity

- CDEs have a primary mission of providing investment capital for low-income communities and are accountable to the residents of that community through a governing or advisory board.

- Delegated authority by US Treasury to sell NMTCs to fund Qualified Low-Income Community Investments (QLICIs).

- Responsibility for ongoing monitoring and maintenance of Sub-CDE.

- CDEs earn fees from obtaining and deploying the allocation and those affiliated with banks earn Community Reinvestment Act (CRA) credit.
What is a “low income community”?

> Based on census tract data – median income, poverty rate and unemployment
> Qualifying vs. “Higher Distress”
  - Includes rural areas, brownfield areas, designated Hot Zones, medically underserved areas, food deserts, Colonias and HUB Zones
> Qualifying census tracts in non-metropolitan counties automatically qualify as “higher distress”
> Qualifying census tracts can be located using a mapping tool on the CDFI Fund website at www.cdfifund.gov
Baker Tilly NMTC experience

› Involved with NMTCs since the program’s inception in 2000
› One of nation’s foremost experts in NMTCs
   – We operate our own CDE (The Valued Advisor Fund), which has received allocations totaling $102 million in NMTCs
   – Assisted in closing 100+ NMTC transactions to date, bringing investment value of over $1 billion to distressed communities nationwide
   – Worked with more than 50 CDEs on successfully structuring and closing transactions
   – Authored 25 award winning allocation applications totaling more than $1.3 billion in NMTC awards
› Strong relationship with country’s leading tax credit investors
› Working relationships with 7 governmentally controlled CDEs

The most comprehensive NMTC consulting practice in the country
Economic benefit to recipient

› Capital to fund projects, business expansion or debt refinancing
  – Tax credits are monetized to bring additional capital to the capital structure
› Low cost of capital
› Flexible loan terms including longer amortization and higher LTV ratios
› Debt forgiveness
  – At the end of the 7-year compliance period a significant portion of the NMTC benefit is permanently forgiven.
NMTC Program Benefits

Community benefit
› Create additional economic development for the local community
› Attract and retain skilled workforce
› Bring new goods or services to underserved communities
› Capital investment to underserved, qualified Low-Income Communities (LIC)
### Historical Allocation

<table>
<thead>
<tr>
<th>Round</th>
<th>Year</th>
<th>Awards</th>
<th>Amount ($ bil)</th>
<th>Avg. Award ($ mil)</th>
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<tbody>
<tr>
<td>1</td>
<td>2001-2002</td>
<td>66</td>
<td>$2.5</td>
<td>$38</td>
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<tr>
<td>2</td>
<td>2003-2004</td>
<td>63</td>
<td>$3.5</td>
<td>$56</td>
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<tr>
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<td>2005</td>
<td>41</td>
<td>$2.0</td>
<td>$48</td>
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<tr>
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<td>2006 *</td>
<td>63</td>
<td>$4.1</td>
<td>$65</td>
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<td>5</td>
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<td>$3.9</td>
<td>$64</td>
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<tr>
<td>6</td>
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<td>70</td>
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<tr>
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<td>10</td>
<td>2011</td>
<td>70</td>
<td>$3.5</td>
<td>$50</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td>664</td>
<td><strong>$33.0</strong></td>
<td><strong>$49.7</strong></td>
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</tbody>
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Critical Distinction

NMTC Allocation ≠ Tax Credits or Cash

The Math

NMTC Allocation $10,000,000
NMTC Rate 39%
Tax Credits $3,900,000
Investor Discount & Costs 49%
Net NMTC Cash to the Project: $2,000,000
What makes a good NMTC candidate?

> Located in a “highly distressed” census tract – any one of the following:
  - Poverty > 30%
  - Median Income < 60% of statewide
  - Unemployment > 1.5 times national average
  - Non-metropolitan county

> Community impact
  - Tangible community benefit – measured by quality job creation, providing unmet goods & services to low income communities (grocery stores), environmentally sustainable construction, etc.
  - Part of an existing plan for economic revitalization
  - “But for” test – NMTC fills a real funding gap that would otherwise not happen

> Ready to go
  - Other sources of funding are committed
  - Approvals all in place
**Funding Options**

<table>
<thead>
<tr>
<th>Potential Funding Options</th>
<th>Cost of Funds</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1603 Grant Funds*</td>
<td>Nearly 0%</td>
<td>Need to have met &quot;start of construction&quot; requirement prior to December 31, 2011</td>
</tr>
<tr>
<td>NMTC Proceeds</td>
<td>Nearly 0%</td>
<td>Not an &quot;entitlement program&quot;, must secure allocation from CDE</td>
</tr>
<tr>
<td>Utility Rebates/Grants</td>
<td>Nearly 0%</td>
<td>Depends on project deliverables and timing for &quot;yearly&quot; program goals/funding</td>
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<tr>
<td>Federal Loan Guarantees/TIF/Other</td>
<td>4-8%</td>
<td>Specific to project location, availability and owner's overall profile of need</td>
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<tr>
<td>Foundation Investments</td>
<td>5-8%</td>
<td>Depends upon fit of project with &quot;Program Funds&quot; available</td>
</tr>
<tr>
<td>Senior Debt</td>
<td>6-9%</td>
<td>Depends upon Sponsor's background and contractual &quot;de-risking&quot; of the project</td>
</tr>
<tr>
<td>Tax Equity**</td>
<td>10-15%</td>
<td>Supply/demand driven and is a fluid market</td>
</tr>
<tr>
<td>Equity</td>
<td>12-20+%</td>
<td>Depends upon technology's stage of development</td>
</tr>
</tbody>
</table>

* Requires a bridge investment (funds received post COD).
** Cost of funds represents cost to project owner with tax liability of its own.

**Observation:**

› Having well established partners and clear communication is critical. Not easy to bridge varying perspectives that exist between engineers, energy, financial and agricultural communities.