Next Steps For The Energy Sector's Stimulus

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The ink was hardly dry on the massive stimulus package signed by the president recently when members of Congress began speculating that yet another boost of federal spending might be needed to prop up the ailing economy.

Yet even while that debate is now beginning to percolate in Washington, there are many signs that disbursing the $787 billion already allocated in the current stimulus package, the American Recovery and Investment Tax Act of 2009 ("Recovery Act"), may be no easy task, even with a palpable sense of urgency around getting these dollars to projects where they will make a difference.

Utility companies and their suppliers, as well as investors, start-ups and other energy stakeholders are following the Recovery Act's provisions, and its complex blend of tax incentives, loans, guarantees and grants aimed at spurring projects and development.

Indeed, while the act underscores a clear commitment to fostering alternative energy and energy efficiency goals, specific incentive paths for even the most "shovel-ready" projects vary, making it critical for companies to weigh carefully their Recovery Act options.

Tax Incentives or Grants—You Make the Call

For starters, companies contemplating renewable energy projects will need to choose between three principal types of tax incentives.

The first is production tax credits which are extended for three years for wind facilities, and for two years for other types of energy producers, such as those involving biomass, hydro power, landfill gas and geothermal.

As a result, wind energy facilities will need to be up and running by the end of 2012, while other qualifying producers will need to be in service by the end of 2013 to benefit from the credits. Most agree that these extensions will help developers build their projects, order equipment and plan for the future.

But a real question is whether there will be demand among investors, such as banks, insurance companies and others, to purchase these tax credits and turn them into "shovel ready" cash. In this tight market for attracting "tax equity," developers may have to choose one of the other options.

The second option allows eligible energy facilities to take investment tax credits, which are already

available for solar and other renewable projects, instead of production tax credits.

This an intriguing option because, while it may provide less money overall than the production tax credits for certain kinds of projects, these credits can be realized up-front, or as soon as the facility starts running, without regard to operational risks of diminished production.

That may allow providers to seek other sources of funding, such as a sale-leaseback market. And longer-term projects may realize benefits during construction, through investment tax credits, which the Recovery Act permits to be taken for "progress expenditures," in certain cases.

The third option is perhaps the most intriguing. It allows developers to claim a cash grant in lieu of tax credits for up to 30 percent of the cost of wind, geothermal and other facilities that are eligible for the production tax credits, as well as fuel cell and solar and "small wind" energy facilities that qualify for the investment tax credits.

Other facilities, such as those using qualified microturbines, may qualify for up to 10 percent of their cost.

These cash grants could be particularly important for developers and other investors who don't have enough tax liabilities to use tax credits. However, the Treasury Department still needs to provide regulatory guidance on the procedures and rules for claiming these grants.

In addition, because the grants cannot be obtained until after the facility goes online, the grants won't be available to be spent during construction.

Thus, potential grantees may wish to consider strategies that combine the grants with other benefits, such as "progress payment" investment tax credits, to help them pay for their projects as they are being built, and not just when they are completed.

The stimulus package provides another potential tantalizing benefit for alternative energy and energy efficiency companies.

The Recovery Act authorizes $1.6 billion for Clean Renewable Energy Bonds and $2.4 billion for Qualified Energy Conservation Bonds issued by state or local governmental or tax-exempt issuers, to finance qualified renewable or energy conservation facilities.

Each entitles the holder to a federal tax credit in lieu of interest payments, but whether this tax credit financing mechanism will actually attract capital investment remains to be seen.

There are other tax incentives embedded within this massive bill that might be available for renewables projects, including a 50 percent first year bonus depreciation deduction for facilities placed in service in 2009—so interested providers should take the time to explore all their options.

Smart Grid and New Transmission: The Question is When?

Utilities and clean-tech start-ups may be interested in another high-profile portion of the stimulus package: $4.5 billion is available for transmission and smart grid projects.

Those might include modernizing the electric grid to include demand response capabilities, enhancing security and reliability, and providing new funding for research and development.

Here again, the funds may not be immediately forthcoming. The Secretary of the U.S. Department of Energy will first need to consult with the Federal Energy Regulatory Commission and other agencies, as well as utilities, states and other stakeholders to develop techniques for measuring peak load reductions and energy efficiency savings.

It's not yet clear how long that process will take, but some time will likely pass before any of these grants will be awarded.

DOE Loan Guarantees—Lowering Financing Costs

Another possible source of financing is the loan guarantees provided by the Department of Energy for renewable energy projects and transmission projects that begin construction no later than Sept. 30, 2011.

Eligible projects could include current commercial technologies already available for renewable technologies, facilities for the manufacture of renewable energy facility components, and upgrades to existing transmission lines as well as construction of new ones.

In the case of transmission projects, the Secretary of Energy is authorized to take into account a variety of factors, including the viability of the project without guarantees, the

availability of other state and federal incentives and the project's impact on certain environmental and energy goals.

The trouble here, however, is that the Sept. 30, 2011, deadline may prove to be an impossible hurdle for newer projects, because it often takes up to five years of permitting before most projects can even break ground. So rather than foster the initiation of new projects, these loan guarantees will more likely aid projects already well along in the pipeline.

The Department of Energy's existing rules and regulations for advanced nuclear plants and other innovative projects (which might be quickly applied to the expanded categories of loan guarantees provided for in the Recovery Act) are quite complex and mandate a detailed two-part application process.

Secretary Chu has indicated the Department's intention to streamline this whole application process, and to consider applications on a "rolling" basis, to improve the efficiency and speed of the approval process, in order to achieve the Congressional intent to create jobs and generally provide stimulus to the economy. Whether this goal can be realized is still an open question.

A Little of This, A Little of That

Without tax credits, wind and other renewable energy projects are often unable to produce enough revenues to cover the debt and equity investments needed to develop their generation facilities in the first place.

Unlike tax credits and other tax incentives, a loan guarantee does not supplement the revenues of a project to make it economically viable, although it does reduce the financing cost.

Indeed, this financing cost benefit is substantially enhanced for the renewable energy and transmission projects for which the Recovery Act authorizes loan guarantees.

Under the existing loan guarantee program, the borrower is required to pay a "credit subsidy" fee to compensate the US government for its risk exposure under the guarantee.

This fee may be quite substantial, and significantly cut into the cost savings that might otherwise be achieved from the issuance of the federal guarantee.

The Recovery Act, however, appropriates $6 billion to cover the "costs of the guarantees" for these projects, thereby relieving the Department of Energy of the need to charge this cost through to the borrowers, and providing the borrowers with financing on particularly favorable terms.

The conference report indicates that this appropriation can be expected to support more than $60 billion of loan guarantees.

It appears, moreover, that a single project could use both a loan guarantee and one of the tax incentives mentioned above.

The Department of Energy recognized as much, when it stated that "in certain circumstances, the multiple forms of federal assistance to the same project could enhance national energy policy priorities."

The Recovery Act provides the potential for a powerful combination of both tax incentives or cash grants from the Treasury, and the sharply lowered financing costs under loan guarantee program, to encourage the development of the projects that fit within its various provisions.

As a takeaway, utilities, alternative energy developers and their financial backers should review the Recovery Act's provisions carefully. Substantive and targeted incentives exist for getting new energy projects underway, but project stakeholders will need to engage funding sources with unique, optimized proposals.

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