Finance & Tax Seminar Winter 2016

Partnership Flips (Deep Dive)

Flip Structure Recap

- Rev Proc 2007-65, applied in both ITC and PTC based projects
  - ✓ Widely accepted in wind and solar transactions with a large investor base vis-à-vis inverted lease or sale/leaseback
- Two party (tax equity and sponsor) transaction makes it efficient
  - ✓ Some debt/equity term negotiations when sponsors use construction loan/back leverage
- Cash sharing can be optimized based on sponsor's objectives
  - ✓ Sponsor may receive a constant share of cash, the level of which can be optimized by balancing parameters of tax equity, back leverage and cash equity investors
- Flip term for ITC deals can range from 6 to 10 years

Unique Challenges: Funding Mechanics

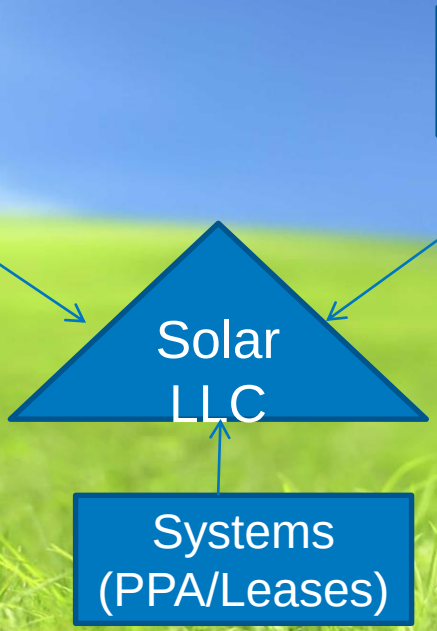
- In a flip structure, tax equity needs to make an investment to become a partner before systems are placed in service/ITCs are accrued
  - ✓ Investors have limited appetite for construction risk
  - ✓ Balancing construction risk vs. tax risk

- Construction risk can be managed
  - ✓ Multiple tranche funding
  - ✓ Conditions precedent before initial funding: systems are “installation ready” or “mechanically completed”
  - ✓ Initial funding of [20%] at mechanical completion, [80%] at substantial completion
  - ✓ Minimum % placed in service before the next funding
  - ✓ Completion guaranty and put back of incomplete systems
  - ✓ Investor’s “at risk” funding a small fraction of its total funding commitment

Unique Challenges: Capital Account Deficit

- Investors typically fund 40-50% of the FMV, but take 99% of tax losses/ITC, leading to large investor capital account deficits
  - ✓ If un-mitigated, Investors would need to take large Deficit Restoration Obligations (30%+)
  - ✓ Loss reallocations during five year recapture period may jeopardize ITC
- A large capital account deficit is not economically advantageous
  - ✓ Losses will be suspended and used post flip
  - ✓ Complicates the exercise of purchase option when large CA deficit outstanding
- DRO can be managed
  - ✓ Year 2-5 allocation (tax loss years) can be reduced from 99% to 67%
  - ✓ Tax losses from Leases can be specially allocated (not subject to 263A)

A Typical Solar Flip Structure



Income (Loss)
Period 1: 1%
Period 2: (years 2-5): 33%
Period 3[flip]: (years 6-7): 1%
Period 4[post flip]: [90%-95%]

Income (Loss)
Period 1: 99%
Period 2: (years 2-5): 67%
Period 3: (years 6-7): 99%
Period 4: [5-10%]

Unique Challenges: Tax Law Changes

- Tax risk allocation between sponsor and investor centers around “Fixed Tax Assumptions”
  - ✓ Investors take “structural risks” based on current laws
  - ✓ Projects/sponsors bear the risk of future changes in law
- Corporate tax reform is a matter of when, not if
  - ✓ Various proposals aimed at reducing tax rate while broadening tax base
- Investors receive protections
  - ✓ Tax rate used for flip calculation would be “floating” vs. fixed at 35%
  - ✓ Any change in law affecting tax credits and tax benefits prospectively

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