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# New EPACT Tax Incentives

*Facts and Reality  
In the **Federal Energy Market***

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**Pit Stop:  
Timely  
Procurement  
Topics**

- **Review of EPACT 2005 Facts**
- **Reality of the Issues in a Transaction**
  - *Sale of Electricity*
  - *Accounting Issues*
  - *Federal Procurement Issues*
- **Federal Renewable Purchase Requirements**



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- **Solar Tax Credit Increase**
  - *Tax Credit increased from 10% to 30% for projects in-service by December 2007.*
- **Production Tax Credit Extension**
  - *1.9¢/kWh tax credit for wind, closed-loop biomass, geothermal for 10 years;*
  - *.85¢/kWh for open loop biomass*



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Topics**

## •**Sale of Electricity**

- Contract Vehicle
- Service Contract Rules
- Shifting Legal Title
- Retail Sales Issues

## •**Accounting Issues for the Contractor**

## •**Procurement Complexity for the Federal Government**



## Reality of the Issues... Sale of Electricity



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- **In order for either the ITC or the PTC to be available to a tax-payer, a sale of electricity must occur from the Contractor to the Federal Agency.**
- **This raises issues as to which contract vehicle is appropriate:**
  - **ESPC** – Some believe it is appropriate, others don't;
  - **10USC2394** Contracts for Energy or Fuel for Military Installations provides 30 year authority for DOD;
  - **Federal Property Act** provides 10 year authority for DOD and civilian agencies;
  - **Enhanced Use Lease** provides one-part of authority, a site lease.
- **Sales of electricity usually have some local sales taxes that must be paid.**

# Reality of the Issues... Service Contract Rules



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- **In addition to supplying electricity, the IRS insists that the contract be considered a "Service Contract"**
- **Four major criteria:**
  - Government can not operate the equipment;
  - Output can only be purchased if delivered;
  - No cost reductions if O&M is cheaper than planned;
  - No bargain purchase option.
- **These are manageable by themselves.**



# Reality of the Issues... Shifting Legal Title



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• **Another set of criteria involves clearly shifting title from the government to the contractor side of the transaction.**

• **Key Issues include:**

- Contractor can take back the equipment at the end of the term;
- Contract term must be less than 80% of the useful life of the equipment;
- Contractor must bear risk of loss;
- Property can't be "limited use property" it has to be removable and usable at another site.



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**•Most states do not permit retail sales of electricity by unregulated entities. And those that do have certain restrictions:**

- California* limits the sales to 2 customers;
- New Jersey* would probably grant an exception;
- Arizona* has retail choice, but it is being challenged, meanwhile one could ask for a declaratory judgment;
- Texas* requires a separation of the owner of the asset from the seller of electricity.
- New York* state permits competition, but the interconnection should be with the local utility
- There is a story in virtually every state except the Southeast, where the answer is a simple, "NO".



# Reality of the Issues... Accounting Issues for the Contractor



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- **Most Contractors account for an ESPC as if it were a construction project:**

- They book the revenue and the margin (profit) either during construction on the percentage of completion method or at acceptance under the completed contract method
- For a renewable project, however, if the Contractor selling the power continues to own the asset, it will generally have to recognize revenue over the life of the contract.
- If the Contractor leases the facility from a 3<sup>rd</sup> party or buys power under most PPA's, it would also have to recognize revenue over the life of the contract.
- Whether this is acceptable to a given contractor is on a case by case basis, but it can be a definite problem if they need/want the revenue now. By the way, there is no impact on contractor cash receipts.



## Reality of the Issues ... Procurement Complexity for the Federal Government



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- **In order to make one of these transactions work for the government, it is helpful if the government appreciates all the hoops that have to be jumped through – regulatory, IRS, accounting, legal.**
- **On top of all the above, most renewable projects can benefit from Renewable Energy Credit programs (“RECs”):**
  - RECs can provide up to 80% of the revenue for certain renewable projects and many projects do not exist without them
  - They are state by state programs;
  - RECs are often part of a separate state procurement.
- **The Government needs to appreciate who actually has a claim on the RECs before deciding a competition based on price alone. Just looking at the bid price is not sufficient.**



## Reality of the Issues ... Federal Renewable Purchases



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- **EPACT 2005 mandates that the Federal government buy renewable energy:**
  - 3% by 2009
  - 5% by 2012
  - 7.5% by 2015
- **Government seems inclined to buy the brown power for a renewable plant, rather the green attributes.**
  - Much of the complexity of REC programs would go away if the government bought the green power.
- **If it is buying renewable, it is buying short term contracts from existing plants, rather than buying long term, from new construction.**



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- **Work is continuing on many projects around the government;**
- **Despite the inherent benefits of most renewable energy projects, it is clear these are very complicated transactions to complete;**
- **EPACT 2005 is an enabler of renewable energy projects, but is only the beginning of the analysis. The tax benefits help make these projects work, but does not guarantee that they will work.**