

# Post-IRA Observations—Where Are We in 2024?

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The linchpin of Joe Biden's sweeping climate change initiative is the Inflation Reduction Act (IRA) passed in August of 2022. The IRA provides massive tax benefits for investment in a broad array of renewable and "clean energy" related projects.

The potential advantages provided for in this legislation are enormous. Now more than one year out, it is clear that this legislative package is on its way to achieving much of its intended purpose, but to be fully successful there are still a significant number of unanswered questions. Following is a brief Q&A addressing some industry observations regarding the financing and implementation of renewable energy projects designed to take advantage of many of these tax benefits.

## Frequently Asked Questions

**Q: What were the challenges and headwinds in getting deals done in 2023? Will 2024 bring more of the same or will there be other, additional, or separate challenges?**

**A:** Generally, uncertainty related to the new IRA Credits added a layer of complexity to the 2023 deals as many investors and sponsors were or are still waiting for additional clarity and guidance on issues like domestic content and other adders/bonus credits.

Some of the complexities parties needed to work through included: negotiating risk allocation regarding these adders, coming up with new funding approaches, modeling IRA trends and approaches regarding uncertainty relating to the adders, and drafting and negotiating language addressing transferability issues and associated liability. It has been necessary to work through these issues while maintaining compliance with the wind safe harbor (e.g., providing future funding flexibility while maintaining compliance with the wind safe harbor regarding 25% contingent contribution limitations) and negotiating potential changes in legal issues or future loss of qualification with respect to bonus credits, for example, due to changes in census tracts, unemployment rates, etc.

Additionally, parties had to wait for further guidance later in the year in 2023 with respect to credit transfers. Parties often had to negotiate or even re-negotiate (depending on the deal timeline) issues raised by the transferability rules, such as negotiating risk allocation provisions associated with accommodating one party's desire to monetize its allocable credits in the future.

Last but not least, parties had to negotiate prevailing wage and apprenticeship language, including with respect to compliance and liability issues.

In 2024, we anticipate that we will see many of the same issues arise, except that a market consensus may have developed as to how these issues will be negotiated / drafted. Additionally, we expect to see more deals that will not satisfy the grandfathering rules for the Prevailing Wage and Apprenticeship (PWA) requirements, and market movement on how such compliance will be documented and negotiated.

**Q: What was the size of the Tax Equity market in 2022, 2023, and expected in 2024? What was the split for traditional verses credit transfer in 2023?**

**A:** Precise figures for the total size of the Tax Equity renewable energy market in 2022 and 2023 are still emerging, and reliable estimates for 2024 are even less solidified. However, the market saw significant growth in 2022, fueled by ongoing renewable energy project development and supportive policies. Estimates suggest the market surpassed US\$15 billion in invested capital. With respect to 2023, the data is still being compiled but early indications suggest continued growth and a market potentially exceeding US\$20 billion. This rise can be attributed to the IRA's initial impact and sustained demand for renewable energy. Finally, we expect sustained or even increased growth in 2024 driven by continued IRA implementation and its enhanced tax credit benefits, potential entry of new investor categories like utilities and insurance companies, and increased focus on project innovation and tailored financing solutions.

**Q: How do you address the challenges of covering a deal?**

**A:** Addressing the challenges of completing a Tax Equity renewable energy deal requires a comprehensive approach involving various stakeholders.

**Here are some general strategies that can be employed:**

- **Thorough Due Diligence:** Conduct thorough due diligence to identify and assess potential challenges early in the process. This includes legal, financial, and technical due diligence to address any issues proactively.
- **Engage Legal and Financial Experts:** Work closely with legal and financial experts who specialize in renewable energy transactions. They can provide guidance on regulatory compliance, financial structuring, and risk mitigation.
- **Government and Regulatory Engagement:** Stay informed about government policies and regulations affecting renewable energy projects. Engage with relevant authorities to understand and navigate regulatory requirements effectively.
- **Risk Mitigation Strategies:** Develop risk mitigation strategies to address specific challenges. This may involve creating contingency plans, securing insurance, or negotiating favorable contract terms.
- **Collaborate with Experienced Partners:** Partner with experienced developers, investors, and financiers who have a proven track record in successfully completing Tax Equity deals. Their expertise can be invaluable in navigating challenges.
- **Stay Informed on Market Conditions:** Monitor market conditions and be adaptable to changes. Stay informed about industry trends, financing options, and tax incentives that may impact the feasibility of the deal.

- **Community Engagement:** Engage with local communities and stakeholders to address concerns and build support for the project. Proactively addressing social and environmental considerations can help avoid potential roadblocks.
- **Financial Modeling and Structuring:** Develop robust financial models and structures that consider the unique aspects of Tax Equity financing. This can involve optimizing cash flows, maximizing tax benefits, and ensuring a favorable return on investment.
- **Transparent Communication:** Maintain transparent communication with all stakeholders throughout the process. Clear communication can help manage expectations, address concerns, and build trust among involved parties.
- **Flexibility in Negotiations:** Be flexible during negotiations to find mutually beneficial solutions. Flexibility in structuring deals and addressing concerns can enhance the likelihood of successful completion.

**Q: What structures are the most prevalent in 2023 / 2024?**

**A:** While traditional Tax Equity deals remained dominant in 2023, the market witnessed a surge in credit transfer deals due to the IRA's provisions. Estimates suggest credit transfer deals captured around 15-20% of the overall market in 2023, and this trend is expected to continue growing in 2024.

**Q: What guidance or clarifications are still needed to support the renewable market?**

**A:** The two areas of great need for additional guidance are the PWA/apprenticeship rules and domestic content rules.

**Q: What are trends in the Tax Equity markets?**

**A:** Some notable trends include the following:

**Increased demand for Tax Equity:**

The IRA significantly expanded and extended tax credits for renewable energy projects, leading to a surge in project development and demand for Tax Equity financing.

The investment community has begun to deploy significant capital through credit purchase transactions and, on the other side, signing up for Tax Equity commitments, sometimes as an accommodation to the sponsor, on the basis that a significant portion of the credits will be offloaded in the credit transfer market.

Growing corporate sustainability commitments and investor interest in ESG factors are further propelling demand.

**Market diversification:**

The traditional investor pool dominated by large banks is evolving, with new players like utilities, insurance companies, and private equity firms entering the market.

This diversification is expected to increase competition for deals and potentially lead to more flexible and innovative financing solutions.

### **Technological advancements and project innovation:**

Advancements in renewable energy technologies and the integration of storage solutions are creating opportunities for new project structures and financing models.

Developers are focusing on optimizing project economics and tailoring financing solutions to attract specific investor preferences.

### **Policy and regulatory developments:**

Continued policy support for renewable energy at the state and federal levels, including potential transmission infrastructure improvements, could further incentivize investment and address grid integration challenges.

Regulatory clarity on issues like credit transferability and basis risk will be crucial for market stability and growth.

### **Focus on ESG and impact investing:**

Investors are increasingly scrutinizing the environmental and social impact of their investments, leading to a growing demand for renewable energy projects that demonstrably contribute to sustainability goals.

Developers are incorporating ESG considerations into project design and documentation to attract impact-oriented investors.

### **Market challenges:**

Despite the positive trends, challenges like rising interest rates, supply chain disruptions, and interconnection delays persist and can impact project timelines and financing costs.

Addressing these challenges through policy measures and industry collaboration will be crucial for sustained market growth.

### **Q: How much Tax Equity is in the capital stack?**

**A:** Based on various industry sources, we understand Tax Equity financing typically accounts for 45-65% of the capital stack for a wind project and 30-40% for a solar project.

### **Q: What affects the cost of Tax Equity?**

**A:** The cost of Tax Equity renewable energy deals is influenced by a complex interplay of factors, encompassing aspects of the project itself, the broader market environment, and the risk profiles of both the developer and the investor. Here is a breakdown of some key influences:

#### **Project-specific factors:**

- Project size and type: Larger projects with established technologies like utility-scale solar or wind tend to attract more interest and potentially lower financing costs compared to smaller or more niche projects.
- Project economics: The overall financial health of the project, including projected returns, debt structure, and operating costs, significantly impacts its attractiveness to investors and the required rate of return for the Tax Equity investor.

- Development stage: Projects in earlier stages of development typically involve higher perceived risks and may command higher financing costs compared to projects nearing completion.
- Location and regulatory environment: Projects located in regions with supportive policies, robust grids, and clear permitting processes may be viewed more favorably by investors, potentially leading to lower financing costs.

**Market factors:**

- Availability of Tax Equity capital: An abundance of Tax Equity investors competing for deals can drive down financing costs, while a constrained market may lead to higher costs for developers.
- Interest rates: The prevailing interest rate environment can impact the overall cost of capital and influence investor risk-return expectations.
- Competition among renewable energy projects: If a large number of projects are seeking Tax Equity financing, developers may face increased competition and potentially higher financing costs.
- Macroeconomic conditions: Broader economic factors such as inflation and market volatility can influence investor risk appetite and impact the cost of capital.

**Risk profile considerations:**

- Creditworthiness of the project developer: Investors will assess the developer's track record, financial strength, and experience to gauge the project's overall risk profile. A strong developer track record can lead to lower financing costs.
- Project risks: Potential technical, environmental, permitting, or operational risks associated with the project can elevate its perceived risk profile and necessitate higher returns for the Tax Equity investor.
- Tax credit certainty: Any uncertainties surrounding the eligibility or value of the applicable tax credits can increase the perceived risk of the deal and potentially lead to higher financing costs.

**Q: How is the IRA affecting valuation?**

**A:** While we defer to valuation experts, the increased tax credits available post-IRA are clearly raising the valuations of renewable energy projects.

**Q: How will the 10 years of steady Investment Tax Credit (ITC) and Production Tax Credit (PTC) change the market in the short and long term?**

**A:** We expect to see continued investment in the ITC/PTC projects in the short and long term, especially with the expanded scope of eligible technologies and the benefit of the adder credits. Steady ITC/PTC projects over a prolonged period can have significant impacts on the Tax Equity renewable energy market in both the short and long term.

**Here are some potential effects:**

**Short-Term Impacts:**

- Increased Investor Confidence: Steady and predictable tax credits create a more stable investment environment, boosting investor confidence. This can lead to increased participation from Tax Equity investors in renewable energy projects.

- **Project Development Surge:** Developers may accelerate project development plans to take advantage of the ongoing tax incentives. This could result in a short-term surge in the number of renewable energy projects coming online.
- **Lower Financing Costs:** Predictable and consistent tax credits can contribute to lower financing costs for renewable energy projects. Investors may perceive lower risks, leading to more favorable terms and conditions for project financing.
- **Technology and Innovation Adoption:** Steady incentives encourage ongoing investments in research and development. This could spur technological advancements and innovation in renewable energy technologies.
- **Job Creation and Economic Growth:** Increased investment in renewable energy projects can contribute to job creation and economic growth in the short term, particularly in sectors related to project development, construction, and operation.

#### **Long-Term Impacts:**

- **Market Maturation:** Over a decade of steady tax incentives can contribute to the maturation of the renewable energy market. It may become a more established and integral part of the overall energy landscape.
- **Cost Reductions:** Continued investment and deployment can lead to economies of scale, technological advancements, and efficiency improvements. This, in turn, can contribute to further reductions in the cost of renewable energy technologies.
- **Diversification of Energy Portfolio:** A sustained period of tax credits can encourage a more diverse and balanced energy portfolio. This diversity may include a mix of solar, wind, storage, and other renewable sources, contributing to a resilient and sustainable energy grid.
- **Infrastructure Development:** Long-term incentives support the development of renewable energy infrastructure. This includes the expansion and improvement of transmission networks to accommodate increased renewable capacity.
- **Carbon Emission Reductions:** A consistent focus on renewable energy can contribute to significant reductions in carbon emissions over the long term, supporting environmental sustainability goals.
- **Policy and Regulatory Stability:** Long-term commitment to tax credits provides policy and regulatory stability, reducing uncertainty for investors and facilitating long-term planning for project developers.
- **Global Competitiveness:** A sustained period of support can enhance the global competitiveness of the renewable energy industry, driving international collaboration and competition in the sector.

**Q: Transferability vs. Tax Equity:** Has transferability stabilized enough that Tax Equity availability is in equilibrium?

**A:** As noted above, we are seeing a mix of approaches on structuring, but expect the market will continue to evolve in this regard.

**Q: Transferability / Hybrid Tax Equity / Transfer Structures: What are the current views on which structures are being requested most and what makes most sense for bank investors?**

**A:** We expect the Hybrid Tax Equity / Transfer Structures will continue to be used to accommodate sponsors and build in additional flexibility to account for a bank's fluctuating tax capacity.

The Hybrid Tax Equity structure will allow investors to maximize benefits since they will be able to claim not only the credits (including any eligible adders) but also depreciation/losses.

**Q: Internal Revenue Service Guidance: What adders are working and which are not?**

**A:** While the market has gotten comfortable with the energy community adders, it is still waiting for further guidance on the domestic content adders. We often see parties negotiating and funding deals with the energy community adders priced in but not domestic content adders.

**Q: Which are the hardest adders to sell and finance? What can sponsors do to be prepared for Tax Equity underwriting?**

**A:** As noted above, we have not seen investors fund / credit transfer domestic content adders. One approach we have seen is where the sponsor may elect to claim such domestic adders at a later date once there is sufficient guidance and to transfer such credits (assuming all risk to the Tax Equity investor is squared off). However, it is a matter of the commercial negotiation of the parties.

If there is continued uncertainty with respect to credit or adder eligibility, we expect that tax insurance may start to play a larger role in deals going forward.

**Q: Do corporates and syndicated investors have a different view on adders than bank investors?**

**A:** We have not seen different investors take on a different view on the adders.

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