

# Financing Strategies for Landfill Gas Projects

**John Marciano**

[jmarciano@chadbourne.com](mailto:jmarciano@chadbourne.com)

202-974-5678



- **The key to financing a project in this challenging market is to stack capital from the cheapest to the most expensive until you have covered the full project cost.**
- **It impossible in the current market to raise all the capital from a single source.**

- **Start by determining what the federal government will pay in tax subsidies. For landfill gas projects, there are two incentives:**
  - **Tax credits and depreciation**

- **A landfill gas project is a facility that produces electricity from gas derived from the biodegradation of municipal solid waste.**
- **Never qualified for a section 45K tax credit.**
  - **i.e., collection system in place no earlier than January 1, 1998, and built under a construction contract entered into before 1997.**

- **These projects qualify for one of two types of tax credits:**
  - **Production tax credits worth 1.1 cent per kWh for 10 years.**
    - **Sell power to unrelated parties.**
    - **No bond financing, subsidized energy financing, other federal tax credits.**
    - **Must go on line before January 1, 2014**
  - **Investment tax credit worth 30% of capital cost**

- **Alternatively, they can opt out of tax credits in favour of a cash grant worth 30% of the capitalized project cost.**
  - **The project must go on line in 2009 or 2010 or**
  - **Construction must start in 2009 or 2010 and it must go on line before January 1, 2014**
    - **Safe harbor to determine if started construction**
      - **5% of costs “incurred”**
      - **New definition?**
  - **Extension**

- **Developers who raise money from private equity funds may not qualify for any cash grant on their projects. Neither do governmental entities that own these projects.**
- **Disqualified entities must invest through a “blocker” corporation.**
- **Last Friday, Treasury officially opened up another avenue.**
  - **Sale-leasebacks**
- **Technical corrections?**

- **The grant is tax free, at least at the federal level (California says that the cash grants are taxable at the state level at 8.84%).**
  - **AMT?**
  - **Other states**

- **As of today Treasury has acknowledged almost \$2 billion of approved grants.**
- **There is no limit – If you meet the deadlines and qualifications, you get the grant**
- **The grant must be paid within 60 days**
  - **2 weeks?**

- **The other tax benefit is depreciation.**
- **For a landfill gas project,**
  - **the collection system and any boiler should be depreciated over 7 years and**
  - **the power train would be depreciated over either 15 (gas) or 20 (steam) years.**

# Alternatives?

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- **The cheapest capital is the 30% Treasury cash grant.**
- **Next cheapest is federally-guaranteed debt.**
  - **Projects that use innovative technologies qualify potentially to borrow from the Federal Financing Bank at 22 or 25 bps above comparable Treasuries.**
  - **Projects that use commercially-proven technologies must negotiate loans from private lenders who can then apply for a federal guarantee on part of the loan.**

**1703 v. 1705**

**> \$15 million?**

- **DOE will accept applications only for simple debt structures, defined as “‘traditional’ senior secured debt . . . not modified to accommodate tax-oriented investment structures.”**

**no refinancings  
five to seven months**

**DOE treats the project cost as net of the Treasury cash grant, and then generally limits the guaranteed debt to at most 80% of that. Thus, for example, a guaranteed loan to a project that uses commercial technology cannot exceed 56% of the project cost. When the grant is paid, it must be used proportionately to pay down the guaranteed debt.**

**no forbearance**

**innovative**

# Tax Credits and Depreciation

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- **Landfill gas projects are rich in tax incentives.**
  - **Production Tax Credits or Investment Tax Credits**
  - **Depreciation – 3 years or 5 years, generally**

- **Tax incentives are only valuable if you have tax liabilities.**
  - **Otherwise, you have to try to monetize—or offload to a private party—those incentives.**
  - **Tax equity v. Debt—math exercise.**
  - **Tax equity is difficult to find for one-off small projects.**
- **How does the cash grant change this?**

## Debt – project-level?

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- If you combine debt at the project level and tax equity, the tax equity will charge a premium of 250 to 300 bps on yield.
- If you move the debt up to the sponsor level, the tax equity will not require a premium but sponsor-level debt will be more expensive because it is farther from the assets,
  - Forbearance agreement

# Tax Exempt and Tax Credit Bonds

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- **Tax-Exempt Bonds**
  - Municipal ownership.
  - No private use permitted.
  
- **Tax Credit Bonds**
  - **CREBs**
    - \$2.4 billion in bond authority. Credit replaces interest.
    - Authorization allocated already.
  - **Build America and Recovery Zone Eco. Development Bonds.**
    - Credit 35% or 45% of interest payable.
    - \$10 billion for public use bonds others – b/4 Jan. 1, 2011.
  - **Recovery Zone Facility Bonds**
    - \$15 billion for private use bonds – b/4 Jan. 1, 2011.

# Typical Options to Monetize Tax Benefits

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- **There are two primary structures for monetizing tax benefits. Basically, the developer barbers the tax benefits in exchange for capital.**
  - **Flip Partnerships**
  - **Sale-leasebacks**
- **A third option (an inverted lease) exists, but has not been adopted widely yet.**

# Partnerships

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- **Partnership Structures are flexible vehicles designed to achieve multi-investor business goals.**
  
- **Earn a return on their investment from a combination of three sources:**
  - **Project cash flow**
  - **PTCs/ITCs or Cash Grant**
  - **Tax losses early in the deal**
  
- **These three revenue streams can be allocated (or distributed) to the partners in different ratios throughout the life of the project.**

# Basic Partnership Flip Structure

## First Period:

**Investor is allocated 99% of income (loss) and PTCs**

**Developer receives all of the cash until it recovers its investment, or a cutoff date**

## Second Period:

**Investor is allocated 99% of income (loss) and PTCs**

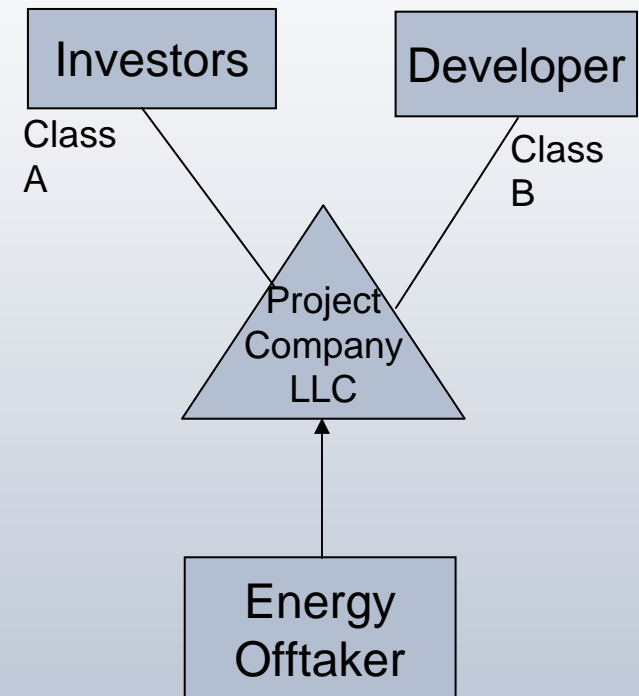
**Investor receives 99% of the cash**

**Until a pre-negotiated ATIRR is achieved by Investor**

## Third Period:

**Once the ATIRR is achieved, Developer receives 95% of project cash flows and profits and Investor receives balance of project cash flows and profits**

## Partnership Structure



# Sale-Leaseback

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**An alternative to the partnership structure is to sell and lease back the project.**

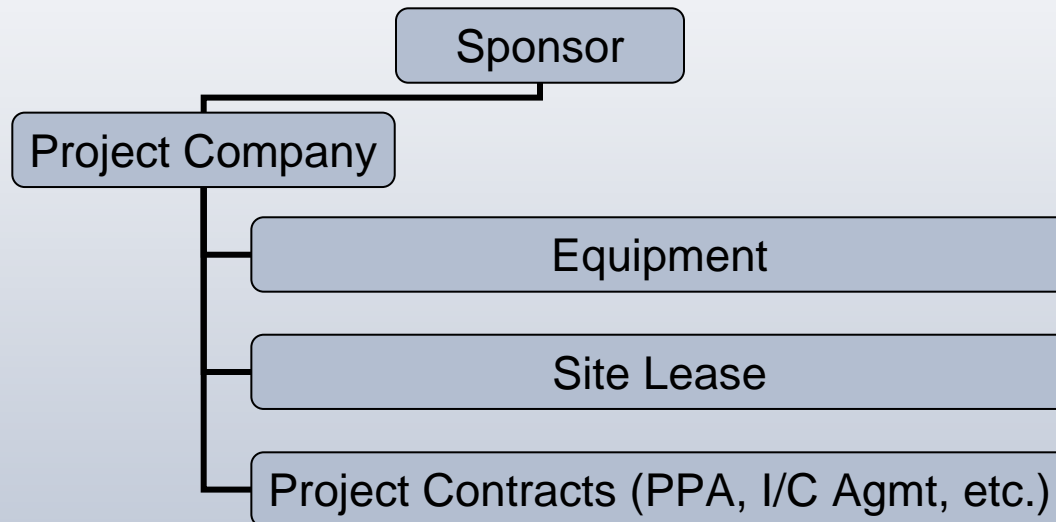
**The tax equity investor claims the tax benefits and passes through part of the value in the rent it charges the developer for use of the project.**

**Leases only make sense if one pushes out the lease term to 80% of the expected life and value of the project. The developer must pay full value at the end of the lease if it wants to keep the project.**

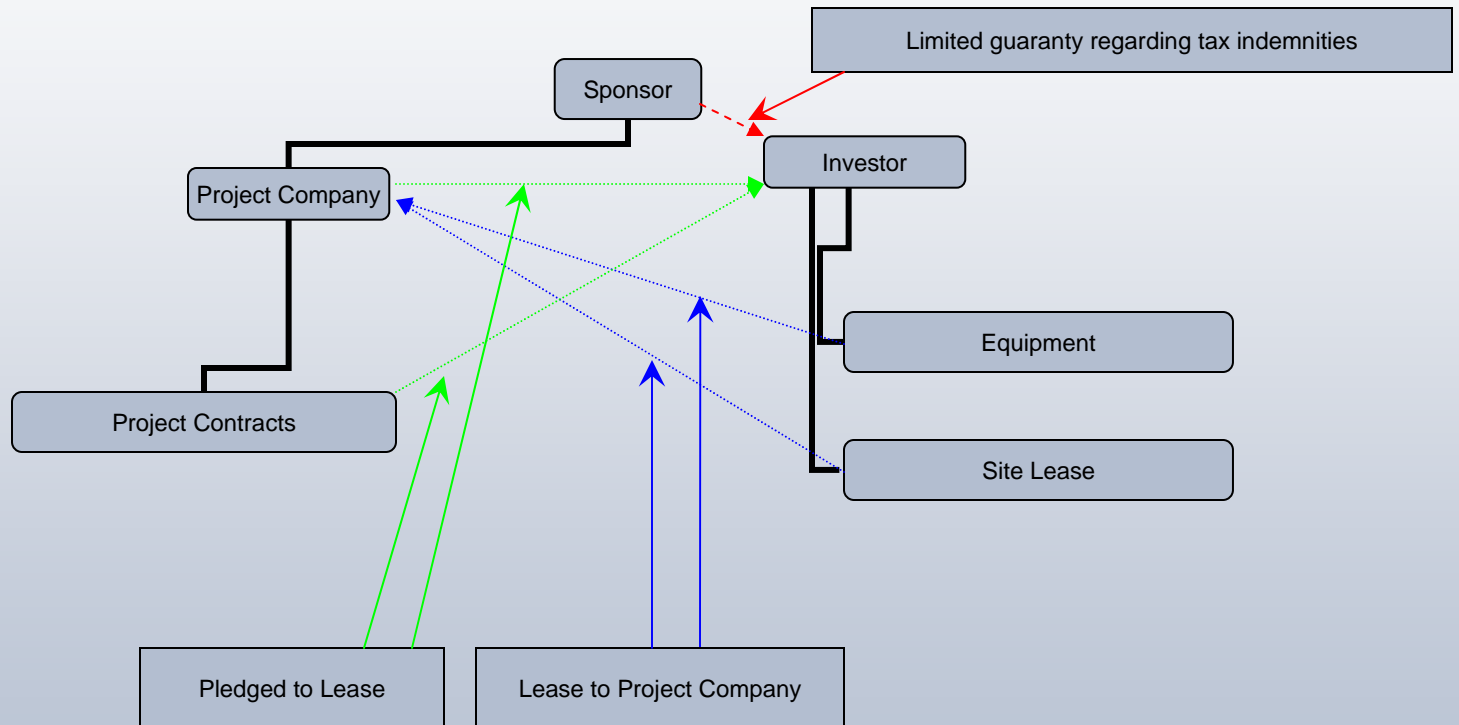
**A sale-leaseback may make more sense in cases where the project is expected to be worth significantly more at the end of construction than it cost to build.**

# Pre-Closing Structure

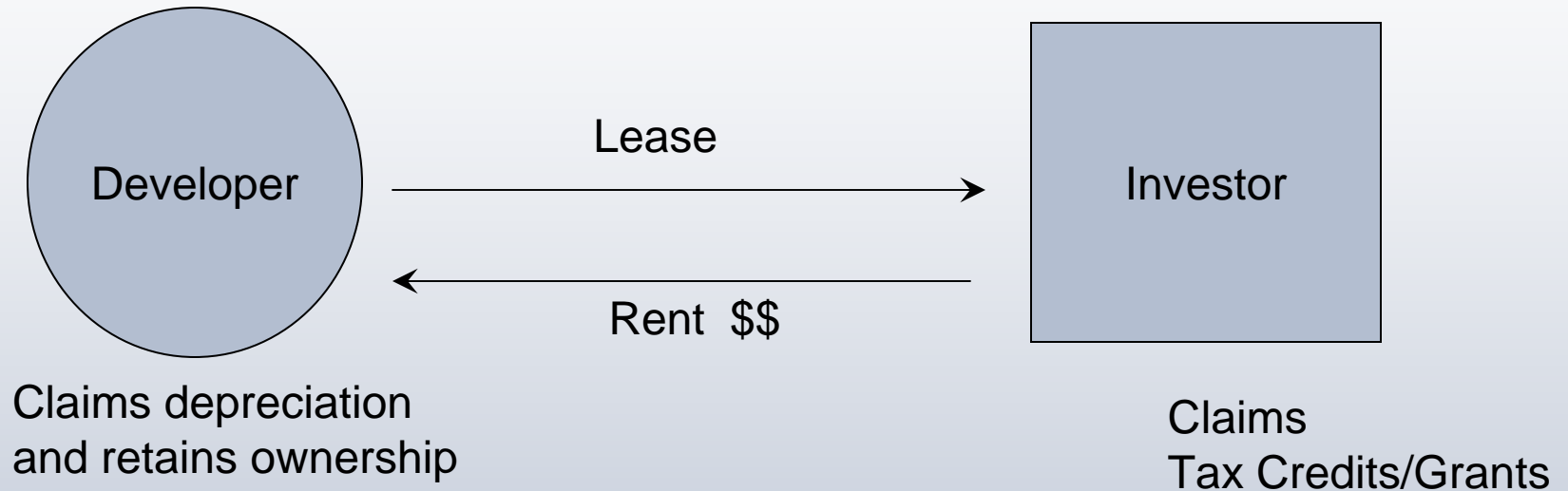
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# Post Closing Structure



# Lease Pass-through



# Lease Pass-through

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- **Think of a yo-yo.**
  - **First, the developer leases the project to a taxable investor for a term of years (e.g., 5 years).**
  - **Then, the parties elect to pass any tax benefits to or grants the investor.**
  - **Lastly, when the lease terminates, the developer pulls control of the project back at zero cost.**
- **Note: at no time does the developer lose ownership.**

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