

## Environmental Law

# Public-Private Partnership for Renewable Energy: A Case Study

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**T**he Morris County Improvement Authority's pilot renewable energy program, structured on a novel public-private partnership basis and recently concluded, achieved its primary goal of providing greater energy savings to local government participants than traditional alternatives. Seven local governments took part in the pilot program, financing 3.2 MW of solar projects for 19 buildings, parking structures and a surface parking lot. Local governments paying electric utility bills based on a tariff north of \$.15/kWh, locked in a 15-year, fixed escalation power purchase price beginning at 10.6 cents/kWh that only increases to present market rates at 16 cents/kWh in the final year of the contracts. This results in an overall programmatic operating budget savings for participating local governments of over 35 percent.

Moreover, with the competitively procured, solar development firm taking all of the development and debt repayment risk, the local government participants were able to obtain the benefits of renewable energy and contribute toward New

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Jersey's 2020 Energy Master Plan goal of 30 percent renewable energy sources without increasing their debt load by a single penny.

Prior to the Morris hybrid program, now being replicated in Somerset and Union counties, with several other counties in various stages of programmatic review, local governments had two decent, but not overwhelmingly attractive options to add a renewable energy source to their existing physical plant. They could issue tax-exempt bonds, thereby achieving a low cost of capital, and availing themselves of the solar renewable energy certificates ("SRECs") that accompany the production of solar facilities that produce renewable energy in lieu of more traditional fossil fuels. Between the low cost of capital and the ability to monetize the SRECs, local governments were able to cover a portion, but not the entirety, of their debt service obligations. In this age of ever tightening budgets and watchdog tax advocates, debt funding for solar panels sounded like a nice idea, but one that many communities were not able to afford.

Alternatively, the state permits local governments to engage in a competitive contracting process set forth in Local Finance Board Notice 2009-10 to secure a private, turnkey solar developer, which

would design, acquire, construct, operate, maintain and finance solar projects on behalf of local governments willing to provide roof or other facility access to the private developer. As all the risk of development shifts to a private vendor, the local governments could enjoy a power purchase price slightly below existing tariff rates, and realize a direct, but extremely modest, budget savings. The solar development model is heavily subsidized. Since the private firm is the owner of the solar panels and related equipment, it receives a 30 percent federal investment tax credit, five-year accelerated depreciation for assets with a 25-year or greater useful life, the aforementioned SRECs, along with the cash flow generated from selling directly to the local government the electricity from the solar panels for use in the building below the roof where the panels are being housed. These four revenue streams allow a private developer to charge the local government a slightly below-market rate. Unfortunately for the taxpayer, the benefits to the private sector appear to materially outweigh the slight savings afforded the local government in the private financing, turnkey model.

The Morris hybrid model combined the best of both worlds by retaining the turnkey features of a private solar venture taking all of the development and opera-

tional risk, while the government sector provided low-cost debt financing that the private sector would have no access to in the normal course of things. Further, by establishing the program at a regional governmental level, the development cost of structuring the transaction could be amortized over several deals, thereby avoiding an unnecessary financial burden on any single deal. More importantly, however, the debt is issued by a conduit county improvement authority, wrapped with a county guaranty in order to provide low cost capital. The bonds are repaid not by the local governments, but rather by the solar development firm. The hybrid model was developed as an alternative to the private turnkey model because the balance between public benefit and private benefit was leaning too far in favor of the private sector, absent finding a way to recover a portion of that benefit through lower pricing. Instead of a nominal savings below tariff, the Morris hybrid model achieved a full 35 percent savings off the present market cost of electricity for its participating local governments.

The primary obstacle in constructing the hybrid model was to minimize or eliminate the potential liability to the county offering its guaranty. Great care was taken to formulate a security package that balanced the competing interests of reimbursement security for the county and cost to the solar developer.

Therefore the requirement of the posting of a letter of credit by the solar developer in favor of the county was deemed too costly, and failed to recognize that there remained value in the transaction, even in a developer walk-away situation. In a developer default, the county improvement authority would regain all rights to SREC monetization value, along with the payments made by the participating local governments from the receipt of their energy. Simply because the developer exits the transaction does not mean that the solar panels stop operating and produc-

ing electricity. In this default scenario, the authority provides the value of the SRECs and the local government energy purchases to the county, thereby leaving the county on the hook for the difference between the amount of bonds paid off by the guaranty and the combined SREC and electricity purchase value. This county deficiency amount could have been funded by a costly letter of credit, but instead was satisfied through a cash payment to be made by the solar developer from a portion of the proceeds of their U.S. Treasury check to be obtained upon completion of the solar panel installation. In the end, the county was protected, and since the solar developer did not have to raise the funds to produce the security package, the impact on energy pricing was slight, and the savings could accrue to the participating local units.

While these savings are real and locked in for 15 years, the pilot program pointed out some impediments in law and policy that, if modified, could significantly increase the savings beyond the present level that has so many county and local governments interested in developing their own programs. For example, state law limits the power purchase agreement ("PPA"), or the agreement that governs the sale of the electricity produced from the solar renewable energy sources to the local government, to 15 years. For some unidentifiable reason, county colleges have a special exemption that allows them to enter into a PPA term of double that of a municipality or school district. Whatever the original rationale for this 15-year statutory limit, the county college exemption demonstrates that a longer-term contract is viable. Moreover, it seems incongruous for a solar panel manufacturer to offer a 25-year warranty, but the PPA contract cannot recover the cost of the debt to finance the project in anything beyond the 15-year state law-imposed final term, which includes options and extensions. That single change could so materially change the cash flow obliga-

tion of a solar developer that PPA prices in single digits are easily foreseeable under the hybrid model, so long as the cost of capital remains relatively low.

In addition, Congress should seriously consider extending the grant in lieu of the investment tax credit beyond 2010, as the financial impact on these transactions of the cash grant, as opposed to a tax credit that is nominally the same in value, is significant. Tax credits never produce the same value as cash due to the added syndication costs frequently required in order to monetize credits for firms having little or no need of the credits directly, together with the inability to sell such credits at par. Since the hybrid structure depends on private tax ownership of the panels, tax-exempt financing is inherently prohibited by federal tax rules, notwithstanding the fact that the energy is being constructed on, and used at, government facilities that usually can finance on a tax-exempt basis. If Congress considers the grant extension, it should also look into adding this additional category for tax-exempt financing.

Congress may also consider reinstating the bonus five-year accelerated depreciation that was permitted in 2008 and 2009, and which expired at the end of that latter year. Bonus five-year accelerated depreciation allows the owner of a solar energy system to depreciate a full half of the value of the asset in the first year, and the remaining amount over the following four years. Bonus five-year accelerated depreciation provides an important additional financial incentive encouraging the development of solar projects.

Together, these suggested changes should enable this renewable energy, public-private partnership model, already proven to provide valued and significant savings, to expand at a rate that could allow regional and local governments to set the pace in achieving the state's renewable energy goal by 2020. ■