In association with clean energy pipeline

U.S. RENEWABLE ENERGY FINANCING AND REGULATORY OUTLOOK

2015

ORRICK

Orrick and Clean Energy Pipeline have launched a series of reports dedicated to exploring investment opportunities and challenges in the global renewable energy sector. In the first issue, we analyzed the investment opportunities arising from the U.S. Department of Defense's major renewable energy procurement initiatives. In the second issue, we explored the evolving dynamics of the UK solar market as the industry moves towards the end of the Renewables Obligation subsidy regime. In the third issue, we focused on the challenges and opportunities in the U.S. energy storage market, with a specific focus on California's energy storage procurement program.

In this issue we reflect on the major trends in U.S. renewable energy financing and M&A in 2014 and anticipate how the market will evolve in the rest of 2015. We also analyze major regulatory developments in 2014 and look ahead to the important policy decisions on the agenda this year.

A busy year on the regulatory front

A number of important policies and regulations were either formulated or came into force in 2014, both at the Federal and State level. The most notable are outlined below:

Wind energy production tax credit (PTC) renewal: On December 16th, 2014, the Senate passed a tax extenders bill that reinstated the PTC until the end of 2014. Projects can qualify for a tax credit as long as they commenced construction by the end of 2014 and maintain a continuous program of work.

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Christopher Moore
Partner in Orrick's Energy & Infrastructure group

This extension was greeted with dismay from the wind energy industry because it effectively only gave developers three weeks to satisfy the commencement of construction criteria needed to qualify. That said, wind installation volumes should be robust in 2015 as the vintage of projects that commenced construction during 2013 (following the previous extension of the PTC in late 2012) come online.

Because projects can satisfy the commencement of construction test by simply incurring 5% of costs before the deadline, some developers have been able to commence construction by the end of December for purposes of qualifying for PTC without actually commencing physical construction on the project site. As Christopher Moore, Partner in Orrick's Energy & Infrastructure group, explains, developers of these projects should be mindful of ensuring they satisfy PTC criteria related to maintaining a continuous program of work.

"The PTC extension in late 2012 required projects to start construction in 2013 and continue to be built," he said. "This created a lot of angst in the financing community because investors were not sure what continuing work meant and whether construction delays could result in you losing your PTC. Then the IRS released guidance saying that as long as you complete construction by the end of 2015 you are fine. But there was, until recently, a question with the extension at the end of last year because there was no guidance on whether you can satisfy the continuity requirements in the same way. However in March 2015, the IRS released Notice 2015-25 which gives developers until the end of 2016 to complete wind projects without having to worry about the continuity requirements."

Efforts are ongoing to secure a further extension, but have thus far proven unsuccessful. In late January 2015, an Amendment to legislation relating to the approval of the Keystone XL pipeline that would have extended the PTC for five years was defeated in the Senate by a vote of 51 to 47. Then, in early February 2015, President Obama proposed a permanent extension to the wind energy PTC and the solar energy ITC as part of his 2016 draft budget. However, this draft is still in its early stages and will be subject to intense negotiation between both parties.

California calls for 50% renewables target: Whatever happens at the Federal level, state policy will have an important role to play in incentivizing renewables. There are already encouraging signs in early 2015 that some states are taking significant strides to promote investment in renewable energy. In early January 2015, California

Governor Jerry Brown called for the state to increase the percentage of electricity produced from renewable sources to 50% by 2030. Currently, utilities are required to source 33% of their electricity from renewables by 2020. A bill has been published that would make this target State law.

FERC proposes changes to priority grid access: In March 2015, FERC (the Federal Energy Regulatory Commission) issued a final rule relating to Generator Tie Lines. FERC established a five year safe harbor period during which the Tie Line owner has priority access to the line. Previously, owners of Tie Lines were required to make excess capacity available to third parties if they requested.

"The Generator Tie Line rule will be an important development for sponsors," explained Adam Wenner, Energy & Infrastructure Partner at Orrick. "If people are building in remote areas, they might have to build 150 mile long lines to get the power to the grid. This issue wasn't necessarily holding back development, but it was always a risk. There have been some instances of third parties seeking access that resulted in big litigation cases."

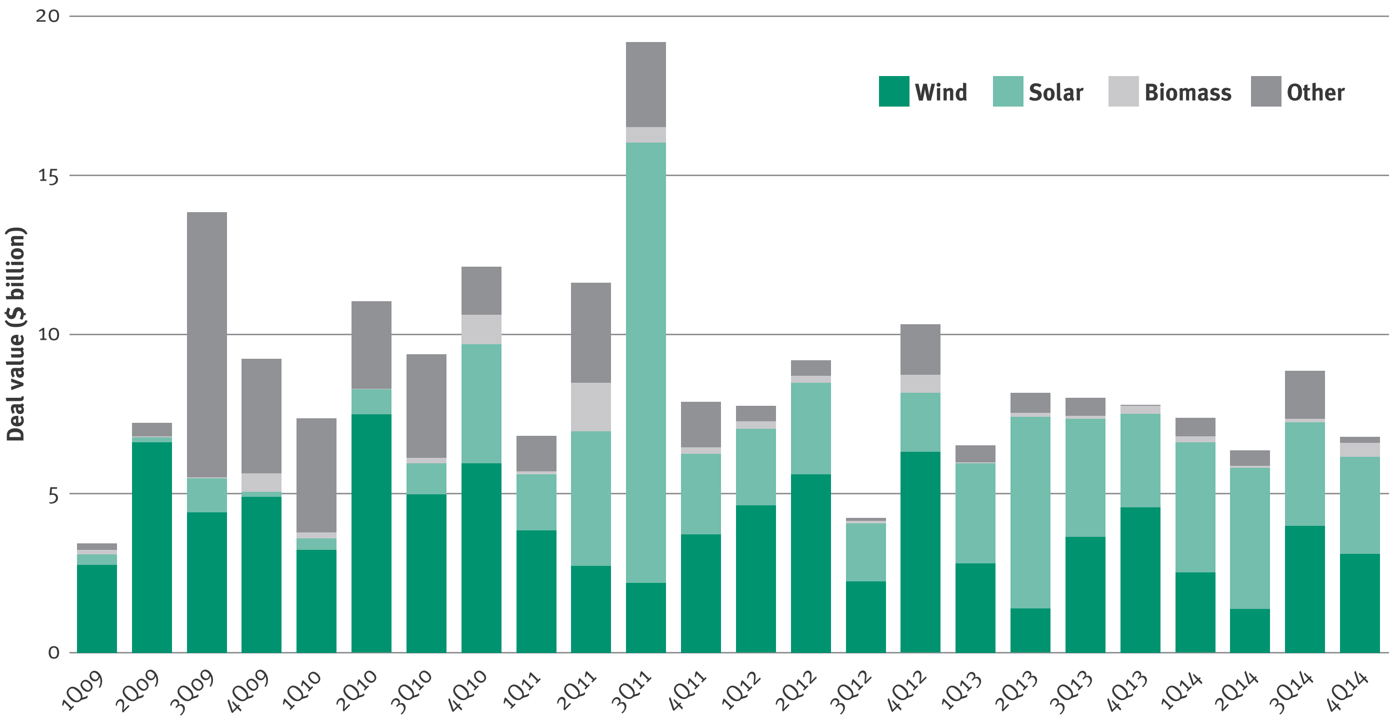
Financing & investment

Investment in wind projects increase: Some $29.3 billion project finance was invested in U.S. renewable energy projects in 2014, in line with the $30.5 billion invested in 2013. There was a notable increase in investment in wind projects, following the release of guidance by the Internal Revenue Service in August 2014 that clarified the criteria for qualifying for the wind energy production tax credit - $7.1 billion project finance was allocated to wind projects in the second half of 2014, an 82% increase on the $3.9 billion invested in the first half of 2014.

Holdco loans growing in popularity: Looking ahead to 2015, one financing trend many expect to materialize is the growing use of back-leverage debt, otherwise known as holdco loans, which are not secured by the actual project but by the cash flow allocated to the sponsor's equity share.

"Utility scale solar projects have traditionally utilized term debt, but this year, many sponsors are choosing

Project finance in the U.S. by sector



SunEdison and TerraForm Power complete First Wind acquisition

In January 2015 SunEdison and its yieldco TerraForm Power completed the $2.4 billion acquisition of First Wind. It is one of the largest ever acquisitions by a yieldco. Key details of the transaction are outlined below:

- TerraForm purchased 500 MW of operating wind capacity and 21 MW of operating solar capacity. The portfolio has an average counterparty credit rating of A-. The portfolio will add $74 million of cash available for distribution in 2015.
- SunEdison acquired First Wind and certain of its subsidiaries, which provides it with an 8 GW pipeline of development-stage projects, of which 1.0 GW is eligible for the PTC.
- TerraFrom and SunEdison secured $2.4 billion bridge financing to fund the acquisition, including $1.5 billion of non-recourse capital secured from six banks and First Reserve Infrastructure.
- Following the acquisition, SunEdison raised its installation guidance 29% to 2.1-2.3 GW in 2015 and 2.8-3.0 GW in 2016.

to fund the projects during the operating phase with all equity (a combination of sponsor equity and funds provided by tax equity investors), at the project level," explained Mark Weitzel, Partner and Co-head of Orrick's Energy & Infrastructure group. "Many sponsors are then funding their own equity contributions through so-called 'back leverage' loans, where they borrow at an upper tier level, which is similar to a mezzanine product. The debt is not secured by the project, but by the sponsor's interest in the project company, without recourse to the sponsor itself. Investors like Ares Capital have been doing holdco deals like this for some time. It is a little riskier and is more like equity, but it has better returns."

Yieldco bandwagon rolls on: Yieldcos, publically traded investment funds that invest in operating renewable energy assets, continued to raise capital in 2014. Yieldcos secured $3.8 billion equity on the public markets in 2014, significantly more than the $1.1 billion raised in 2013, according to Clean Energy Pipeline. There are indications in early 2015 that more yieldcos will come to market. In February 2015 First Solar and SunPower announced they are in advanced negotiations to form a joint yieldco to which they will contribute a portfolio of solar generation assets.

The rise of yieldcos is stimulating M&A activity. According to deals tracked by Clean Energy Pipeline, yieldcos acquired 3.8 GW of effective capacity (the capacity of the project multiplied by the stake acquired) in 2014, compared with 2.6 GW in 2013. The increase was due to more yieldcos coming to market and an increase in the size of acquisitions. For example, in November 2014, SunEdison and its yieldco vehicle TerraForm Power agreed to acquire First Wind Holdings for $2.4 billion (see box above).

"Existing yieldcos will continue to be strong acquisition vehicles," explained Mark Weitzel. "They made promises to the public to deliver a 3-5% cash yield every year, and the total return, including annual growth, is supposed to be much bigger. The only way to achieve this is to continually be in acquisition mode. SunEdison and Terraform have a very assertive program, as do NRG, Abengoa and NextEra. There will likely be more yieldcos in 2015. Three to five companies have made yieldco registrations. I would expect more to come out in the first half of the year, as long as the capital markets continue to be strong."

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Corporates demonstrate strong appetite for renewables investment: Corporates ramped up their renewables investment activity in 2015 with the likes of Google, Microsoft, Ikea and Amazon all announcing investments or plans to source significant proportions of energy from renewable sources. Some corporates are investing in renewables to obtain long-term fixed prices for energy, while others are investing to enhance their green credentials or to take advantage of the tax benefits.

For example, in November 2014, Ikea acquired the 165 MW Cameron wind farm in Texas from Apex Clean Energy, its largest wind farm acquisition to date. Seven months earlier, it acquired the 98 MW Hoopeston wind farm in Illinois. The company plans to invest $1.7 billion in renewable energy projects in 2015 as part of plans to source 100% of energy consumption from renewable sources by 2020. The likes of Apple, Amazon, Facebook and Google have also committed to source 100% of their energy demand from renewable sources in the future.

"A lot of corporates such as IKEA, Walmart and Amazon are entering the market, while Google has been active for a while, and is becoming more active," explained Christopher Moore. "Some are just entering into PPAs while others are investing tax equity, so they are coming in different capacities and providing different sources of capital to the market."

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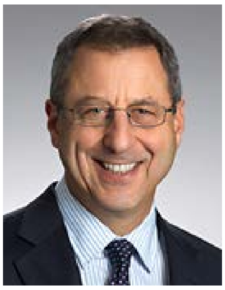
Christopher J. Moore is a partner in the New York office and a member of the Energy and Infrastructure Group. His practice involves a wide variety of project finance and corporate transactions in the energy sector, including tax equity monetization, construction and term debt, and acquisitions and dispositions of power projects and related facilities. In particular, Mr. Moore has extensive experience in transactions designed to monetize U.S. tax benefits for an individual power project and portfolios of power projects, including structures utilizing the Federal Production Tax Credit (PTCs) or the Treasury cash grant, such as partnership flip structures and lease transactions.



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Adam Wenner, a partner in Orrick's Washington, D.C., office, heads Orrick's Energy Regulatory Group. Mr. Wenner has been active in the energy industry for more than 25 years. As Deputy Assistant General Counsel at the Federal Energy Regulatory Commission, Mr. Wenner was instrumental in the development of the federal programs and policies that fostered the independent power industry, and his experience includes representing independent power generators -- including some of the largest wind and solar projects in the United States -- as well as "merchant" transmission companies, traditional electric utility companies, before FERC, state utility commissions and NERC Regional Reliability Organizations.

About Orrick

Orrick is a global law firm with 1,100 lawyers that work as an integrated team across 25 offices throughout the globe. Orrick has one of the world's leading energy practices, composed of over 100 lawyers with deep experience in the energy field focusing on projects in the United States, Europe, Asia and Africa. The energy practice is a core part of Orrick's overall strategy, allowing the practice to mobilize internal resources to expand our global outreach and take advantage of market opportunities. We are particularly noted for our leading practices in energy project development and finance, governmental energy funding, public private partnerships, and venture capital and emerging company representation in the clean tech and renewable energy sectors worldwide.

Lawyers in Orrick's renewable energy practice represent developers, lenders and investors in the wind, solar, geothermal, waste-to-energy, ethanol, fuel cell and other clean energy technology sectors. Our lawyers have significant experience in the development and financing of renewable projects all over the world, and they routinely draw upon the experience of members of the firm's securitization, real estate, bankruptcy, regulatory, environmental and litigation practices when handling such matters.

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