March 8, 2022

Via Electronic Submission

Hillary H. Salo
Technical Director
Chair, Emerging Issues Task Force
Financial Accounting Standards Board

RE: EITF Issue 21-A, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method

Dear Ms. Salo,

The American Council on Renewable Energy ("ACORE") is a national nonprofit organization dedicated to advancing the renewable energy sector through market development, policy changes and financial innovation. ACORE's membership includes renewable energy developers, institutional investors, corporate buyers, electric power generators, retail energy providers, and other stakeholders interested in accelerating renewable energy investment in support of our nation's climate and economic goals.

ACORE supports the FASB's decision to add *EITF Issue 21-A, Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method* to the EITF's agenda. In certain situations, the application of current accounting methods result in financial reporting that inaccurately reflects the appearance of a non-economic equity investment in renewable energy projects, limiting sector investors to far below the number of its potential participants. Therefore, we support expanding the proportional amortization method of accounting to renewable energy tax credit structures. In the sections below, we provide background on tax equity structures in the renewable energy sector, the obstacles presented by current accounting rules, and considerations for expanding the proportional amortization method to renewable energy investments.

We would be pleased to follow up and discuss these issues with the EITF or FASB Staff if that would be helpful.

Background on the U.S. Renewable Energy Sector

Renewable energy is an increasingly critical component of the nation's power mix, outcompeting fossil sources of electricity in much of the country, delivering tangible economic benefits and putting Americans to work. The sector enhances the security, reliability and resilience of the electric grid and is readily deployable and available even during extreme weather conditions. With more than $40 billion in U.S. investment last year, renewable energy is also one of the nation's most important economic drivers. Over the longer term, renewable energy has a critically important role to play in achieving the emissions reductions that scientists say are necessary to mitigate the worst impacts of climate change. The increase in renewable energy generation between 2005 to 2019 led to the reduction of approximately 248 million metric tons of greenhouse gas emissions.[1]

Renewable energy project investors use several methods to finance projects. However, the accounting methods that are applied to renewable energy investments (for both tax equity and cash equity investors)

[1] https://www.eia.gov/todayinenergy/detail.php?id=48296

often diverge from the full economics of the transactions. Additionally, investors may incur significant costs when applying these complex accounting methods for these investments.

Tax Equity Financing

Renewable energy projects typically have a high level of contracted revenue, limited variable operating costs and relatively predictable cash flows. Projects are often held in a limited liability corporation ("LLC") and treated as partnerships. In most cases, the project developers do not have tax liabilities and thus are unable to efficiently use the tax benefits (e.g., depreciation and tax credits) that may be available for these projects. Thus, the developer sells a non-controlling interest in the LLC in a tax equity transaction, thereby allowing a tax investor to monetize the tax benefits of the project to optimally finance the project. The structure is designed to allow tax equity investors to fund a portion of the cost of the project and to receive a pre-negotiated target rate of return, which consists primarily of the value of available tax benefits realized as well as any cash received.

Tax equity investments provide a significant source of capital for wind and solar project finance, responsible for approximately one-third of the average capital stack for a solar project and two-thirds of the capital stack for a wind project. The renewable energy tax equity market represented approximately $19-$20 billion in 2021,[2] roughly split between solar and wind investments. A $25 million tax equity investment, for example, could facilitate a 66 MWdc solar installation that would generate electricity sufficient to power 350,000 homes for a year.[3]

However, a report BloombergNEF released in August 2021 documented tax equity constraints due to an increase in demand from renewable energy developers.[4] According to the report, current tax equity availability is insufficient to meet the Biden Administration's climate goal of eliminating power sector emissions by 2035. Tax law uncertainty, the ongoing pandemic, supply chain issues, and other factors could compound constraints to tax equity supply in 2022. It is critical for the industry to ease hurdles for both existing and new market entrants and attract nontraditional investors to enable the renewable energy growth we need to achieve the nation's climate targets.

Accounting rule challenges have created an unnecessary burden for tax equity investment structures. Investors considering their first tax equity investment are initially excited about the potential earnings and Environmental, Social and Governance ("ESG") benefits. That enthusiasm is quickly tempered by the large negative operating earnings typically recognized under the current equity accounting treatment, and many CFOs categorically prohibit these investments for that reason. Additionally, there is an enormous amount of time and expense spent attempting to understand the appropriate accounting for tax equity investments under the flip structure (e.g., HLBV). The amount of lost tax equity investment due to the current accounting rules is in the billions, and perhaps tens of billions, of dollars.

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[2] https://www.projectfinance.law/podcasts/2022/january/ep185-cost-of-capital-2022-outlook/

[3] https://www.monarchprivate.com/esg-investing-news/view/who-invited-hlbv-to-the-party-and-can-someone-please-kick-them-out/

[4] https://www.bnef.com/login?r=%2Finsights%2F27041
BloombergNEF reported 45 GW of clean energy projects scheduled to come online in 2021-2022 that did not have confirmed tax equity financing, and 6.6 GW of projects expected to come online by end of 2022 that did not announce having secured tax equity funding and had not begun construction. At the time, BloombergNEF tracked 8.3 GW of solar projects and 6 GW of wind projects not yet online that had secured tax equity funding for 2021-2022. BloombergNEF predicted a shortfall in financing for solar projects of 5.9 GW and for wind projects of 0.7 GW – about 10% of the anticipated build. Smaller developers were most likely to experience shortages as investors favor larger businesses.

Application of the HLBV Method in Tax Equity Investments

As discussed above, renewable energy entities often establish a partnership and sell a portion of the partnership interest to an investor to monetize the tax benefits shared by the project. In a majority of tax equity structures, an investor would account for its investment in a renewable energy project under *ASC 323 Investments – Equity Method and Joint Ventures*, in which case it would apply the equity method of accounting. Renewable energy investments are typically categorized as either tax equity or cash equity. This industry nomenclature is used to distinguish an investment by the means in which it achieves its return on and of its capital. A tax equity investor typically will share disproportionately in the initial earnings of the project until an agreed upon after tax internal rate of return is achieved.

Therefore, due to the variable nature of the allocations in tax equity structures, application of the hypothetical liquidation at book value ("HLBV") method of income allocation has become widely employed, modifying the traditional equity method. The HLBV method has some significant shortcomings when used by investors to account for renewable energy tax equity investments. Among them are:

- Determining the investor's share of assets in a liquidation scenario can be complex and involve interpretation of the partnership liquidation provisions of the operating agreements.
- HLBV requires the investor to use the GAAP assets as the foundation for the liquidation value. However, the remaining tax benefits to be generated by the project are not reflected in the financial statements of the LLC, creating a disconnect between project accounting and project economics.
- Project GAAP assets often can remain high due to long useful lives which can mean the hypothetical liquidation value exceeds the economic value and impairment losses become necessary, even when project performs as expected.

Moreover, when using the HLBV method, the tax equity investor realizes their return primarily through the allocation of tax losses associated with accelerated depreciation and tax credits, while the developer is allocated income due to the change in each investors' claim on the net assets of the business. This occurs due to the return calculation for the liquidation waterfall used for HLBV which includes the value of the tax benefits and tax credits received by the tax equity investor. The value of the tax credits is not reflected in assets, income or equity of the project. Thus, a lower share of net assets is allocated to the tax equity investor, resulting in a GAAP loss in proportion to the tax benefits received.

Considerations for the Application of Proportional Amortization to Renewable Energy Investments

For the proportional amortization method to provide a better alternative to HLBV for tax equity investors in renewable energy investments, it should provide an accurate representation of the investment economic benefits, and the costs of application cannot be prohibitively high. Some items for consideration are:

- Because renewable energy tax equity investors do receive a portion of their return from cash, the proportional amortization method criteria would have to change by lowering the "substantially all of the benefits to come from tax credits and other tax benefits" threshold.
- Current guidance states the evaluation of whether the conditions to apply proportional amortization are met are to be made at the time of initial investment and only reevaluated if there is a change in the nature of the investment or a change in the relationship with the entity. While production tax credit renewable energy investments are expected to have more variability in the amount of tax benefits and the ratio of tax benefits to cash benefits than low-income housing tax credit investments, these investments will continue to be held primarily for the purpose of

receiving tax benefits. Therefore, we recommend that the final guidance explicitly state that normal course variability does not require reevaluation of whether the conditions in paragraphs 323-740-25-1 through 25-1B have been met.

- In order for the proportional amortization method to align with the economics of renewable energy tax credit investments, the amortization must include cash distributions, in addition to tax credits and other tax benefits (including cash distributions from the post-tax credit time period).

Expanding the option to include an alternative for equity method investors to use proportional amortization method for equity investments in renewable energy tax credit structures better reflects the economics of these transactions while opening the door to more investors with tax base. Therefore, we recommend the inclusion of renewable tax credit investments for consideration in EITF Issue No. 21-A.

Appendix: Tax Equity Structures

Tax equity structures vary in the amount of tax equity they raise, their risk allocation, and their funding deadlines for the tax equity investor.

I. Partnership Flips

Use: This is the standard vehicle for PTC projects and used in 80% of current solar deals.
The basics: A solar or wind developer partners with a tax equity investor to own a renewable energy project together. There are multiple variations of flip structures:

A. Yield-based flips typically entail an initial 99% allocation of taxable income, loss, and tax credits to the tax equity investor (with the other 1% allocated to the solar or wind developer). The economic allocations "flip" once a target yield is reached by the tax equity investor (usually within 6-8 years). The developer is also typically given the opportunity to buy the investor's interest at the time of the flip. Typically, the investor's allocation drops to 5% of taxable income and loss post-flip and the developer's allocation increases to 95%. Post-flip purchases of the investor's interest are usually based on fair market value ("FMV") but the IRS also allows fixed-price purchasing (assuming a good-faith estimate).

B. Fixed-flips are typically less common and can maximize the cash retained by the solar or wind developer. The changing allocations of taxable income, loss, and tax credits are the same as in yield-based flips – the main difference is the flip date is fixed. Additionally, in fixed-flips, the tax equity investor usually receives annual preferred cash distributions (2% of their equity investment) with the remaining cash going to the developer. Post-flip, there are typically call options that allow the developer to buy the investor's remaining 5% interest at FMV.

II. Inverted Leases

Use: Mainly in the rooftop market. Some utility-scale transactions.
The basics: The renewable company is the lessor in this transaction. The company leases the renewable energy asset, such as rooftop solar, and assigns customer agreements to a tax equity investor who in turn collects customer revenue and pays most of it back to the company in rent. The investor receives the tax credit and the company keeps the depreciation. At lease end, the company takes back the asset. In the utility-scale market, the investor is assigned a long-term power contract in place of customer agreements.

In conservative structures, the investor contributes the tax equity investment to a lessee partnership that is 99% owned by the investor and 1% owned by the company. In such structures, the capital moves from lessee (the investor) to lessor (the company) via prepaid rent.

Overlapping ownership structures take an additional step: the lessee partnership contributes the capital it receives from the investor into a lessor partnership that is partially owned by the lessee partnership (but is never owned by more than 49% by the lessee for tax reasons). This allows the investor to claim part of the depreciation, which raises more tax equity.

III. Sale-Leasebacks

Use: Common in commercial, industrial, and small utility-scale solar markets. Uncommon in the rooftop market.
The basics: The developer sells the project to tax equity investor and leases it back. The tax equity investor gets all tax benefits, which are calculated based on the FMV it pays for the project. In theory, a sale-leaseback raises full FMV of the project, but the developer (lessee) typically has to pay back 15-20% of the raised capital in prepaid rent. Additionally, some sale-leaseback agreements allow the seller to buy back the asset after the lease ends.

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